FINANCIAL STATUS OF THE CROP INSURANCE INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON
GENERAL FARM COMMODITIES
AND RISK MANAGEMENT

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

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FINANCIAL STATUS OF THE CROP INSURANCE INDUSTRY

THURSDAY, MAY 22, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL FARM
COMMODITIES AND RISK MANAGEMENT,
COMMITTEE ON AGRICULTURE,
Washington, DC.

The subcommittee met, pursuant to call, at 10:00 a.m., in room 1300, Longworth House Office Building, Hon. Jerry Moran (chairman of the subcommittee) presiding.

Present: Representatives Smith, Lucas, Rehberg, Graves, Burns, Musgrave, Peterson, Alexander, Dooley, Pomeroy, Boswell, Marshall, and Larsen.

Also present: Representative Osborne.

Staff present: Jon Hixon, subcommittee staff director; Dave Ebersole, senior professional staff; Craig Jagger, Callista Gingrich, clerk; Kellie Rogers, John Riley, and Anne Simmons.

OPENING STATEMENT OF HON. JERRY MORAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. MORAN. Good morning, everyone. Our subcommittee will come to order. I am happy to welcome our USDA officials as well as company representatives to this subcommittee hearing as we begin our review of the crop insurance programs.

Crop insurance plays an increasingly important role for many farmers and ranchers. Following the passage of the Agriculture Risk Protection Act of 2000, products were expanded, higher levels of coverage were supported and many substantial changes were made to this important USDA program. This past year was a difficult one for agricultural producers across the country. Over $4 billion in insurance indemnities were paid nationwide and losses from the drought in my State of Kansas alone exceeded $1.4 billion.

The crop insurance reforms passed in 2000 had the benefit of increasing the baseline by $8.2 billion. The challenge for members of the committee today is much different and more difficult. I have heard from—in fact the most common conversation I have with members of this subcommittee, with the full Agriculture Committee, and other Members of the House interested in agriculture is very much about what we can do to improve crop insurance programs. Improvements can be made, but we are operating under much tighter fiscal constraints than in 2000 and we understand the issues before we begin that process.

It is my hope today that this hearing will begin to shed some light on the financial status of the industry and how the Risk Management Agency has implemented changes mandated in the last 3 years. After today's hearing I expect this committee will hold additional hearings both here and out across the country to focus on changes needed in terms of products for producers, delivery of programs and other issues that we may uncover.

I welcome our witnesses today and look forward to their testimony, and I recognize the gentleman from Minnesota, Mr. Peterson.

OPENING STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. PETERSON. Well, thank you, Mr. Chairman, and thank you for your leadership in calling this hearing.

This is an issue that is extremely important to my district. I welcome all the witnesses and especially Mr. Jim Brost, who is one of Collins Associates from my district in Minnesota. And I, you know, was involved in the last reform of crop insurance on the conference committee, and we made some significant progress in addressing some of the issues. But I have to say in my district, it still is not meeting the needs of my constituents in certain areas. With, you know, us getting into this international marketplace where we have really seen the trade changes and the competition bring the margins down to the point where you don't have much room for error or problems, in my area we have gotten into a wet cycle where we have been in—some places have lost their crop 8 years out of 10. And even though we changed this plug, you know, to 75 percent in the last bill it really doesn't work for these folks. If they have losses 2 or 3 years in a row, you try to get to the higher coverage. It does not make economic sense to pay that amount of premium for what you can get out of it. It just doesn't work.

And so we have a situation where people are out there with a lot of risk and no way to cover it. And we have looked at a lot of different ways to try to deal with this, you know. I guess the problem is that they all cost money and we can't figure out where to get the money to do it. But I would hope that out of the hearings that we have here today and I guess we are going to have some field hearings around the country, that we would try to figure out a way to address this. If we cannot fix crop insurance to give people a system that economically works so they can cover their risk, I think what we need to do is put in place a permanent disaster program that is part of the farm program that the Secretary can enact or invoke, similar to what we do with FEMA.

I mean, we have got a situation with FEMA where if you have a town that is flooded they come in and they declare a disaster. They are on the ground immediately and they don't have to wait for Congress to act or anything, and we deal with the situation, you know, and if we can't fix crop insurance I think we need a similar system for agriculture where the Secretary would have the authority to come into that county if it is declared and deal with the problem and have a pot of money available similar to what we have at FEMA to do that.

Now, I would prefer we do it through crop insurance, and I am not politically sure whether we can accomplish this, but in my judgment that is what is needed. If we can not make the crop insurance situation such that they can buy the kind of coverage they need, I think we need to have some kind of permanent disaster program as part of the farm program, because for a hundred years, you know, we were fine. Then all of a sudden we got this wet cycle and we are not fine, and we don't have a way to deal with it.

So I look forward to working with you, Mr. Chairman, and others to try to figure out a way to deal with these problems. And I know you have had some drought issues where we would like to figure out how to build a pipeline so we try to get some of this water down to Kansas and we would solve both of our problems. So thank you for your leadership and look forward to the testimony of the witnesses.

Mr. MORAN. Mr. Peterson, thank you for you cooperation. I appreciate our witnesses being here today, and I would recognize the two gentlemen at the table: Mr. Ross Davidson, who is the Administrator of the Risk Management Agency, along with Dr. Keith Collins, the Chief Economist at the USDA. It is my understanding that Dr. Collins' testimony will commence the hearing.

Dr. Collins.

STATEMENT OF KEITH COLLINS, CHIEF ECONOMIST, U.S. DEPARTMENT OF AGRICULTURE

Mr. COLLINS. Thank you very much, Mr. Chairman, members of the subcommittee. I appreciate being invited here this morning to join Mr. Davidson to address crop insurance and risk management issues in U.S. Agriculture. In addition to being Chief Economist as you introduced me, I am also Chairman of the Board of Directors of the Federal Crop Insurance Corporation, my comments this morning are going to focus on the activities of the Board of Directors, particularly since passage of the Agriculture Risk Protection Act of 2000, known to everyone as ARPA.

ARPA made substantial changes to the functions and responsibilities of FCIC. For example, the act increased the private sector representation on the Board. The private sector membership went from 4 of 7 to now 6 of 9 total voting members, and I think that change alone symbolized the emphasis that ARPA placed on the private sector, not only for guidance to the management of FCIC, but also for the research and development of new risk management products.

Now, the Board of Directors has met 31 times publicly since ARPA was enacted in the summer of 2000, and the work of the Board has cut across a wide range of management issues. To help deal with that we have established for the first time governance and audit and finances committees to address those responsibilities. But much of the effort over the last couple of years has focused on submissions of new private products for sale to producers. The Board has to make determinations on submissions of new products by issuing a notice of intent to disapprove a product not later than 90 days and then approve or disapprove the product not later than 120 days after the receipt of a complete submission. The Board has to contract with independent actuarial and underwriting experts for independent reviews of the submissions and then we have to take those reviews into consideration when we make a decision to approve or disapprove a product.

Since the enactment of ARPA, we have had over 150 independent expert reviews conducted on over two dozen submitted products and program modifications. The Board currently has about 40 expert reviewers under contract to perform this work. The Board has approved several new risk management products over the last couple of years, including four livestock pricing products, whole farm insurance policies, such as AGR-Lite, Adjusted Gross Revenue Lite, expansions for existing products such as revenue assurance, new specialty crop programs such as forage seed, and the expansion of certain pilot programs such as the pecan insurance pilot program.

Another board effort has been the review of the rating structure of APH, Revenue Insurance and Crop Revenue Coverage plans of insurance, and that may lead to some substantial changes in the premium structure for most crop insurance products. The Board has also reviewed Crop 1's Premium Discount Plan, and we recommended its approval subject to certain conditions being determined by the Risk Management Agency.

As we look to the future, the Board is going to work very closely with RMA and Mr. Davidson to improve the risk management capacity of farmers and ranchers. In order to ensure the best possible use of FCIC resources, the Board has authorized two studies to look at FCIC's current and their future products. One study is focusing on inconsistencies and overlaps between the authorizing legislation, our regulations and all of the material that we put out, the handbooks and everything else.

The second study is assessing the whole broad portfolio of products of the Corporation with specific attention to coverage and overlaps, and I think that that is going to help RMA and it is going to help the Board deal with the very large number of pilot projects and feasibility studies that are in the pipeline and that are probably mostly going to have to come to the Board for approval or termination at some point.

In conclusion, the FCIC Board is committed to strengthening the Nation's crop insurance and other risk management programs and the regulatory functions of the Risk Management Agency. All of the Board members are pleased to have the opportunity to serve American agriculture, and all of them are working very hard to ensure that this very crucial part of the farm safety net functions as best as it possibly can.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Collins appears at the conclusion of the hearing.]

Mr. MORAN. Thank you, Dr. Collins.

Mr. Davidson, the Administrator of RMA. We appreciate your leadership at the agency and welcome you to our subcommittee.

STATEMENT OF ROSS J. DAVIDSON, ADMINISTRATOR, RISK MANAGEMENT AGENCY, U.S. DEPARTMENT OF AGRICULTURE

Mr. DAVIDSON. Thank you very much, Mr. Chairman. It is a pleasure to be here to discuss the progress and the challenges that face RMA as it has implemented ARPA. We have made a lot of progress in that area to implement both the letter and the intent of ARPA and to also Secretary Veneman's vision under our Board of Directors' leadership.

ARPA provided additional subsidies for crop insurance. As you are aware, those are fully implemented and it has had a major effect on the participation in the program. In 2002, over 50 percent of the insurable acreage was insured at 70 percent coverage or higher. That compares to only 9 percent at that high level in 1998. But there is a lot more to do, as Congressman Peterson has suggested, to not only fulfill the intent of ARPA, but also to fulfill the vision that Secretary Veneman has for crop insurance.

Secretary Veneman recently asked RMA to review its products, commodities, risks and areas covered to better serve producers, and we are undergoing the extensive review that Dr. Collins has mentioned to you. In addition to that, we are conducting listening sessions throughout the Nation in all of our regional office areas with producers and producer groups and receiving a lot of very good and constructive feedback upon which we intend to act.

Currently, there are a variety of insurance products available to producers, and we have a number of pilot programs for livestock, for range and specialty crops that are in the process of operation and 30 or so other feasibility studies ongoing for product development. Let me just give you a few examples of the major issues that we are working on.

As we all know, excessive long-term drought has plagued and continues to affect many producers in the United States. We have demonstrated commitment to producers during this last year that was a very heavy drought stricken year. We paid over $4 billion in indemnities. That compares to $3 billion in 2001. And so this program is responsive to drought situations, but not as responsive to long-term drought as I would like to see it. We have coverages within our products for prevented planting due to drought that covers producers in times of excessive and multiyear droughts. That is a complex coverage, difficult to administer. We are working with producer groups and the insurance industry to try to simplify and make it more effective at the same time providing producers with more information on how to access that coverage. Many producers have found that they actually have more coverage under that provision than they thought.

We are also evaluating some revisions to the yield substitutions that were mentioned earlier, to possibly address long-term production declines, such as those that are induced by extended drought. But there is a lot more work to do in this area, and we would agree with Congressman Peterson that we need to figure out a way to deal with long-term declining production. The APH structure is not as adequate as we would like to see it.

With regard to livestock rangeland and forage, an area that ARPA authorized, we were authorized to insure several types of animals and animal products, including dairy. The FCIC Board recently approved and announced the Livestock Risk Protection Pilot Program for fed and feeder cattle. Both of those programs protect cattle producers from declining prices. RMA is in its second year of insuring slaughter hogs in Iowa as well, under two different pilot insurance programs.

We have also received a lot of interest from many States in the expansion of Pennsylvania's Adjusted Gross Revenue-Lite program which provides significant coverage for livestock and livestock products. On May 7 the FCIC Board of Directors sent a submission for expansion of that product out for expert review.

We are also testing pasture and forage products in order to fulfill ARPA's requirements. The Group Risk Protection Rangeland, or GRP Rangeland pilot is currently offered in 12 Montana counties. We are working with producers and the contractor to address the issues that have arisen out of that pilot program, and we have contracted for an evaluation of this program. We also have a feasibility study, specifically for pasture and rangeland to determine if an individual risk management program can be developed rather than the group program.

The performance of the APH Forage Program is also being reviewed and the contract has been awarded to improve the loss adjustment methodology and to determine the feasibility of a forage quality adjustment. We are also doing feasibility studies, as is topical today, with regard to livestock disease, particularly catastrophic diseases. Cost of production has been of interest to all of us. It is a new and untested insurance concept and approach. We have contracted to develop a cost of production product. There are many issues, including the program design, rating, delivery and administration that still must be addressed. We are working through those with the contractor. Pending resolution of these issues to the FCIC Board's satisfaction, the policy for cotton may be available for 2004. Any decisions regarding expansion of the program to other crops would be decided by the FCIC Board, taking into consideration the experience of any initial pilot program.

We are working extensively to provide coverage for specialty crops, as mandated by ARPA, particularly nursery. Improvements to the nursery program are in process.

Another example is apples. In conjunction with U.S. Apple and others, RMA has been working to make improvements to the current policy. We hope to reach consensus soon and will do everything that we can to expedite appropriate changes.

We have also emphasized education and outreach as funded by ARPA. In 2002, RMA established 13 cooperative agreements to deliver crop insurance education to underserved States. We awarded 72 partnership agreements to conduct producer training in risk management with the priority to producers of specialty crops. And RMA Civil Rights and Community Outreach Division entered into 46 outreach partnerships covering approximately 34 States. And these programs reach tens of thousands of producers annually.

With respect to the premium reduction plan under direction from the FCIC Board of Directors, RMA recently published procedures by which any reinsurance company may apply to offer a premium reduction plan under strict standards for approval and operation. RMA has exerted and will continue to exert, careful regulatory oversight of these types of programs to ensure compliance with Federal law and the provisions of the standard reinsurance agreement, particularly with respect to the proper use of licensed agents, producer service, and illegal rebating and tying prohibitions.

There has been some interest with regard to the renegotiation of the Standard Reinsurance Agreement by which we share risks with the insurance companies. As you know, the current SRA has been in effect since 1998. There is a provision for a one-time renegotiation in the 5 years. RMA plans to announce renegotiation of this SRA, effective for the 2005 reinsurance year, within a month or two.

American Growers Insurance Corporation. As you know, we experienced a failure of the largest insurance provider within our system last year. We continue to work with the Nebraska Department of Insurance, the Rehabilitator of American Growers, in assuring the timely service and payment of claims. There have been about 29,000 claims that had to be paid. As of last week fewer than 275 claims remain open. An additional 24 or so claims were added last week. The transfer of the 2003 crop year policies that American Growers wrote is proceeding effectively to all of the other companies in the industry. We believe this has been a very good example of Federal-State regulatory and industry cooperation in dealing with what could have been a very difficult situation. It has gone relatively smoothly.

Secretary Veneman recently charged RMA to examine its own authorities and processing to ensure effective oversight of the Federal crop insurance industry. RMA is increasing its oversight of the companies participating in the Federal Crop Insurance Program, and we are looking at our authorities to strengthen those.

In addition, program integrity, compliance, fraud, waste and abuse are issues on which we continually focus. A recent Wall Street Journal article suggests that there is continuing work to be done there, and we all know that. ARPA gave us some tools to deal with fraud and we are using those tools. While RMA believes that most producers use good farming practices and comply with Federal regulations, there are some instances of waste, fraud and abuse that continue. We have launched several initiatives which have proven successful in deterring and detecting fraud, including FSA on-site inspections, data mining, satellite and other forms of remote imagery and GIS technology. Through data mining, RMA has reduced program costs an estimated $94 million by preventing payments on potential fraudulent claims, and we have also generated recoveries of approximately $35 million through our fraud investigation and prosecution efforts. Some may think of it as prosecution, not persecution efforts. RMA data mining also we believe has reduced potential improper payments from over $210 million to just over $100 million.

In conclusion, since the passage of ARPA, RMA has been very active in accommodating the needs of America's producers through effective products and effective delivery system, education and outreach and sound regulation. There are improvements that need to be made to the program, and we look forward to working with you on those improvements.

RMA is proactively striving to fulfill Secretary Veneman's and the President's continued commitment to better serve our Nation's producers. Thank you for the time, and I would be happy to answer any questions.

[The prepared statement of Mr. Davidson appears at the conclusion of the hearing.]

Mr. MORAN. Mr. Davidson, thank you. I just have one broad question and then I want to turn it over to Mr. Peterson. Just generally in light of the $4 billion indemnity payments that were made last year, that level of payment, as well as the bankruptcy, do you have concerns about the financial stability of the crop insurance industry? And are we satisfied that we should not anticipate additional companies in jeopardy?

Mr. DAVIDSON. We are monitoring very closely all of the companies in the Federal crop insurance industry. A viable delivery system is very important to this program. I am not yet satisfied that all those companies are as healthy as they need to be to continue operation effectively. Many of them are. But we are monitoring several companies and looking very closely and working with them. I do think that this is going to be a constantly vigilant situation that we have to deal with, and we are taking proactive steps to ask the companies to manage their expenses, which is a major issue in this system.

We have gone through a bad year. The industry basically broke even last year from an underwriting perspective. Unlike other insurance companies, these companies are not afforded the benefit of investment income, because basically we keep hold of all of the cases, and so it is not like you can break even and get ahead with investment income. You have got to make your increase in year to year financial stability through operating profits. So it is an issue that we are constantly looking at.

Mr. MORAN. Dr. Collins?

Mr. COLLINS. I don't know that I could add too much more to that. I think the Board is very concerned with that. We get regular reports from Mr. Davidson on the financial health of the industry. I think it is a good sign that in a year like 2002, when we had a loss ratio of about 1.4, as Mr. Davidson says, the industry is pretty much breaking even on underwriting gains and losses. It could have been worse.

One of the pressure points we see of course is what is going on in the reinsurance industry ever since September 11, and I know you have a witness that is going to address that issue and that is of concern to us as well, because, of course, increases in reinsurance rates don't get passed on through premiums because we regulate the premiums. But it has been important for the Board of Directors and important for the Secretary of Agriculture to notch up the oversight and monitoring of the financial health of the industry, and that is exactly what Mr. Davidson is doing. He has put out a call for more financial information from the companies so he can do a better job. In fact, he has reorganized within the Risk Management Agency and now has a division, a group of people, that are dedicated to that monitoring and oversight of the companies and their financial health.

So I think we are on the right path and we can detect, hopefully earlier, the kinds of problems that we saw with American Growers last year.

Mr. MORAN. In your role, Doctor, as the Chief Economist, you do lots of prognostications. Do you have prognostications about weather conditions and the consequences on the Risk Management Agency?

Mr. COLLINS. That is a great question, Mr. Moran. I struggle with economic forecasts and now you ask me to do weather. But they are probably in the same boat.

Mr. MORAN. We have great faith in your skills, sir.

Mr. COLLINS. I don't. I would say one thing about this though. When you look at the perspective, the long-term perspective of crop insurance, you can go back and look at the 1990's. You know we were spending a billion dollars a year on crop insurance, $500 million in some years, $1.2, $1.3 billion in other years. I think we have a benchmark now, a baseline that is going to be about $3 billion per year and rising. We see $4 billion because of bad weather in 2002, but, you know, it wasn't that long ago that the direct payments, the production flexibility contract payments for producers were $4 billion a year, and we thought that was a huge number and now I think we are heading toward crop insurance being $3 billion to $4 billion a year.

Mr. MORAN. Because of more coverage?

Mr. COLLINS. Because of more coverage. More buy-up levels of coverage and higher participation rates, but in particular, the buy-up levels of coverage and the new products that people are out there insuring with and paying a higher premium for because of the benefits they provide. So, you know, the days of us debating whether we should have crop insurance or not are gone. We are debating about how to fix crop insurance and make it even better because it is now such a crucial part of the safety net. So I think as we look out we just have to—I know this is not the appropriations subcommittee—but we just have to put that marker in there of $ billion plus a year for crop insurance.

Mr. MORAN. I thank you very much.

Mr. Peterson.

Mr. PETERSON. Well, thank you, Mr. Chairman. As I said in my opening statement, we still have a lot of producers that are complaining that, you know, about the degradation in insurance coverage that results from these multiple year losses. So last December, Mr. Davidson, I think you testified that RMA is evaluating the yield substitution process to determine if more assistance can be provided. You know, what is the status of that work and where are you at with that?

Mr. DAVIDSON. We are continuing our work. As you mentioned in your opening statement, some of the issues have to do with can you appropriately price that and can it be affordable. We have not completed that work. But we are continuing to evaluate yield substitutions as a possibility, either higher cups or some other approach. We have also looked at extending or shortening the time frame with the APH structure as a possibility. That doesn't seem as promising. There are also other things that people in the industry are looking at as supplementary coverage on top of the existing APH structure, which hopefully may have some promise as well.

So we are continuing our evaluation. The key challenge that we have is pricing that and making it affordable.

Mr. PETERSON. Can you tell me what you are looking at? Is there any specific? Do you have the authority——

Mr. DAVIDSON. No, we would have to come back.

Mr. PETERSON. You would have to come back and change the law?

Mr. DAVIDSON. Yes.

Mr. PETERSON. So I mean you are stuck with the 75 percent plug, for example?

Mr. DAVIDSON. That is my understanding. We would have to have additional authority to come back to be able to modify it. But we are doing the feasibility work at this point in time.

Mr. PETERSON. Right. Are you looking at, for example, what a 100 percent plug would cost and whether that is workable? Are those the kinds of things you are looking at?

Mr. DAVIDSON. Yes. Yes.

Mr. PETERSON. But you are not done with all of that yet?

Mr. DAVIDSON. We are not done with that, yes. There are a number of issues, other than price of course, the potential for abuse and things of that nature. The moral hazard also has to be evaluated.

Mr. PETERSON. Well, I think, you know, given what happened this last, you know, with the disaster situation, I think it is pretty clear that crop insurance is not filling the complete safety net. Would you not agree with that?

Mr. DAVIDSON. Well, I was interested in your comments. I come from another part of the property casualty insurance industry, in fact the home owners industry, and your comments about FEMA were very appropriate, I think, with regard to the great role that they play. FEMA, however, works within the context of a private insurance system that does provide coverage for damage to homes. There is also a Federal Flood Insurance Program that exists and then FEMA comes in on top of that and provides additional assistance where those programs don't work.

I think that it is probably too much to expect that any insurance program would cover everything. It doesn't in the private market. I doubt that it ever will here. It can make a substantial contribution as part of the system and it has. The $4 billion that was paid out by crop insurance this year was money that did not have to be paid out in disaster assistance. And so I think it is better to look at it as part of the context of the whole system. And I am not sure that you will ever get rid of all disaster payments, just like we haven't in FEMA, where we have a very vibrant private industry.

Mr. PETERSON. I guess my point is that, you know, we made this change in 2000 and we have had these discussions that we are going to eliminate disaster. Everybody talks tough but then when it happens, we invariably pass a disaster program, which we did, I don't know, how many months ago was that, January, after, you know, a lot of political pressure. So I think it seems to me it is pretty obvious that the crop insurance was not adequate because of all the political pressure from all over the country to have a disaster program. You know, and I, for one, would like to, if we could craft a disaster program that would take care of these problems so we didn't have disasters, I think that would be a good thing. But I don't think we are there yet. And if we can't, I think it would make more sense to have some kind of a rational program that the Secretary has that could zero in on where the problems are rather than these political fixes that are put forward.

If the Senate disaster program would have passed, it would have been a disaster for this country, because we would have paid producers that didn't have any losses money they didn't need and we wouldn't have taken care of people that you know had problems. Thank God, we were able to fix that and make it somewhat more rational, but it looks to me like we have still got a problem.

Mr. DAVIDSON. Well, there is an interesting interplay between disaster assistance and insurance. And if somebody thinks they are going to get the coverage for free, you know, why buy insurance. So there really is a public policy issue that has to be addressed. The Flood Insurance Program dealt with that by saying, you know, if you are still building in the flood plain, the next time you are not going to get coverage, and there is some discipline that has to go into that.

Mr. PETERSON. Right. But it took us a long time to get that into the process, into the law.

Mr. DAVIDSON. Yes.

Mr. PETERSON. You know, and I think we are kind of going through the same thing in agriculture.

Mr. DAVIDSON. Yes. I think we are a few years behind where we were there, and you know we are just moving on and having to make those decisions.

Mr. COLLINS. Not to delay or extend Mr. Peterson's time here unfairly, but there is another part of this argument about designing disaster programs so they don't discourage crop insurance, and Congress has done a good job at that. In fact, you could argue they may have done too good a job at that. We have now provided substantial benefits for people to buy crop insurance and not be discouraged by disaster payments because we in fact pay people a higher disaster payment rate if they have crop insurance. You can go too far in the other extreme by providing crop insurance indemnity plus a disaster payment that gets you back to being fully whole, and what that can do is encourage production in high risk areas where maybe it shouldn't be. It can also encourage moral hazard problems.

So all I am saying is that there are two sides of this argument about the interaction between disaster payments and crop insurance, and if you are going to design a new disaster payment program, you need to take both of those into account, and I think Congress did that to some extent with the 95 percent cap, which was a new provision in the most recent disaster bill.

Mr. PETERSON. OK. Thank you.

Mr. MORAN. Mr. Peterson, I almost became a believer over the last 12 months that there would be no disaster, no disaster payment. I was almost a believer, having fought that fight for a dozen months.

The gentlewoman from Colorado, Ms. Musgrave.

Mrs. MUSGRAVE. I just would like to ask a question if I could of Mr. Davidson. Also, thank you. I had some farmers in my district who had some specific questions about prevent plant and you sent someone out from Kansas City to try to sort that out, and I appreciate it very much.

Mr. DAVIDSON. Hope that was helpful.

Mrs. MUSGRAVE. I have some questions in regard to prolonged drought. Of course in Colorado we are experiencing a 300-year drought. So we are having a great deal of difficulty surviving. And in some of my district there is irrigation and fertilization done before crops are planted. Some farmers get their water in a ditch. Some have pivot sprinklers. You are aware of all that. But my point is when a farmer is trying to determine whether or not they can expect a crop to bring yield, they don't, at certain points in that process, they may not have had enough water to put it on the ground before they planted as they always do. They may have a date by which they have to plant or they cannot expect their crop to yield over 60 percent, say. So what I don't understand with prevent plant is how are you assisting the farmer in making that decision and convincing the adjuster later on that at that particular time I made the right decision when I said there is no use in me putting the seed in the ground.

Could you help me with that?

Mr. DAVIDSON. You have identified the crux of the issue. It is a very complex situation when a farmer has to make a decision whether he can expect, with the amount of water that he expects, to be able to bring a crop to fruition, and that is of course the standard that is looked at. What I suggest to farmers is document all of your decisions as much as you can. Get independent sources of information together when you are making the decision. You should make the right decision for your farm. In the loss adjustment at the end we would like to avoid second-guessing of that decision, and I think that is what you are talking about.

Mrs. MUSGRAVE. My farmers express to me that when they try to get independent sources of information that no one wants to stick their neck out. You know, who is going to say to the farmer, yes, at this particular date you are making the right decision. Where do they get those independent sources to step up and verify? I mean, are they looking at long-range weather reports? Are they, you know, where do they get these?

Mr. DAVIDSON. There is a range of information that I would suggest that a producer have. Yes, look at long-range weather reports. Take a picture of the drought monitor in your area. Look at recent precipitation. Look at the reports with regard to reservoir levels. If there has been any announcement with regard to the availability of irrigation supply, look at that. Look at subsoil moistures, which can be tested at that point in time. Document all of those things and then make your decision. A producer will not get somebody to tell him whether or not it is right for him to plant. But he can get all of that circumstantial evidence together to make and defend his decision. And then our loss adjusters need to frankly be reasonable in terms of looking at that information.

Mrs. MUSGRAVE. You know, if ground is under water it is obvious. But when you are trying to predict the amount of water that you will have at specific points in the growing season, it is incredibly difficult. And I do think in regard to the added land situation, there are individuals that are not trying to abuse that at all, and they are trying to sort out how to. Land that has been previously insured that has been added and they are not abusing the system, but they still need assurance for the banker.

Mr. DAVIDSON. That is true. Thank you very much.

Mrs. MUSGRAVE. Thank you, Mr. Chairman.

Mr. MORAN. You are welcome. The gentleman from Washington.

Mr. LARSEN. Thank you, Mr. Chairman. Appreciate the opportunity to appear here today and ask a you few questions. I want to first off thank Mr. Davidson for bringing up Dave Paul, your Northwest Regional Administrator, a few weeks back to visit with me. I visited Spokane. We had a very good conversation, a good introduction for me to crop insurance, and I was especially interested to hear from Mr. Paul about the success of the AGR program in central Washington State, in the Columbia Basin, that many of the specialty crop producers there are accessing. You might know a fraction of the producers in my own district in western Washington have access to crop insurance. There are over 130 different crops grown in my district, and only a handful of them have access. Of those eligible many are skeptical of the USDA and RMA just generally and that may be more a function of my district, if anything. I will deal with that.

Mr. DAVIDSON. I come from Montana. I know what you are talking about.

Mr. LARSEN. I see my good friend from Montana is not here. But in your view, how can programs like AGR and AGR-Lite be expanded, extended to specialty crop producers in western Washington and other places where there is maybe either some skepticism or just not good access to a good product.

Mr. DAVIDSON. Well, your area is not unlike the Northeastern area that has a very diverse agricultural environment as well, and it is in the Northeast where AGR-Lite was hatched. It basically grew out of an effort to look at adjusted the gross revenue product and ask how it could be modified to meet the needs of diverse small farms. And Pennsylvania spearheaded that effort and, in fact, it is the first product that we have that a State agricultural department has sponsored in this program, which is very encouraging.

Since that time, the FCIC Board of Directors has approved a product for Pennsylvania. There are a number of other States that are interested, and Pennsylvania has come back with a request of the Board of Directors to expand that. I am very encouraged by this development. I think it is a way for a revenue product to be adjusted to meet the needs of the local agricultural environment. It is a way in one fell swoop to provide coverage for a range of smaller agricultural commodities like those that exist in your area, so I am quite encouraged. The States where adjusted gross revenue exists already, it is easier to do an Adjusted Gross Revenue-Lite because it uses the same rating structure as adjusted gross revenue.

So I would encourage you to work with Mr. Paul, who is very willing to do that, and come back to the Board of Directors with a proposal. Possibly your State agriculture department might be a way of doing that.

Mr. LARSEN. That is great. You bring up an important point. You called it the local agriculture environment, and I think that is an important phrase because it is something probably more particular to a region as opposed to spreading it nationwide, and for certainly in a place like my district, where there is a wide diversity of crops grown, probably more appropriate than maybe some other types of product. Can I touch on the apple growers, if I may?

Mr. DAVIDSON. Sure.

Mr. LARSEN. You brought that up and that came up in a conversation with Mr. Paul, and I know you recently sat down with some of the Washington State apple growers, Mr. Paul did. I really do appreciate the outreach there. It is important for them, it is important for our State. You mentioned some time lines generally. You talked about soon, and things like that.

Mr. DAVIDSON. We don't want to underdeliver.

Mr. LARSEN. Then I don't need to ask my next question. Do you think you have a time line or a time frame for delivery or at least a process to go through?

Mr. DAVIDSON. Well, this has been a very extensive process. I think you appreciate that. It not only includes the National Council, but also includes a lot of regional interests, many of which differ. I have been on listening sessions throughout the United States. I have been in California, Utah, Washington, New Hampshire, and in all of those areas there is a different issue that has to be dealt with with the apple industry. So bringing a consensus together has been a challenge, and there is almost a consensus at this point in time. The administrative process after getting a consensus is fairly extensive. There has to be a rating done and there has to be the policy, and then the Federal Register has to go through, so there is a lot to do. And we have gone through, walked through that time line to ask ourselves, could something be done for 2004 and, frankly, it would be a miracle to be able to get something for 2004. But frankly, my people, not my people, but the RMA staff regularly produce miracles, and so I am hoping that there will be something that can be done.

Some of that may require some adjustment in, for example, the contract change date. I don't know if you are familiar with that term, but it is the place at which the contract gets fixed and that is what you got for the year. We will have to look at that and we are looking at that. We have a commitment to try to get something done this year if at all possible.

Mr. LARSEN. Okay. Well, I appreciate that very much. And Mr. Chairman, I really appreciate the opportunity as well to ask questions, and thank you for calling this hearing.

Mr. MORAN. Thank you very much, Mr. Larsen.

Mr. Smith, the vice chairman of the subcommittee.

Mr. SMITH. Mr. Chairman, likewise, important hearing. I tell my farmers that government pays for between 60 and 70 percent of the cost of the insurance. What is the right figure?

Mr. DAVIDSON. Well, it depends upon the level of coverage that they provide.

Mr. SMITH. Give me a range.

Mr. DAVIDSON. About 60 percent. It ranges from 38 up.

Mr. SMITH. What is the status of payouts for the last year's disaster?

Mr. DAVIDSON. We are continuing to make payments on last year's disaster. Those payments are right at $4 billion currently.

Mr. SMITH. Fifty percent done?

Mr. DAVIDSON. No. We are well, I would say that we are probably almost, I am told 95 percent done.

Mr. SMITH. That is good.

Mr. DAVIDSON. Yes.

Mr. SMITH. I wrote the original amendment in 1996 for risk insurance, and at that time we ended up with some different language. But at that time I had an idea that there were other expansions of risk insurance. So anyway, I should say, Dr. Collins, Mr. Davidson, thank you for being here.

Dr. Collins, don't retire. Stay with us. The language there was broader in terms of my perception of what we might do to reduce risks on farms. Part of it was making it easier for farmers to forward contract and it is somewhat difficult now, dealing with the Chicago Board of Trade and other areas. I think we should work on your ideas of how we can make that kind of forward contracting and the way it is accomplished easier for especially smaller farmers. Right now at a 5,000 bushel minimum, sometimes the smaller farmer doesn't have the opportunity that the larger farmers have.

The other area of risk has two parts. One is the risk of the input, the price of the inputs and the other is the price of the outputs. I think we should study, and I hope you will consider doing it, areas where we either might implement or might come up with suggested legislative language for better forward contracting of inputs. You can do it to a certain extent now. But I think we should expand it and make it easier and maybe even put it on the commodity exchange if that is an advantage. Is that possible, Mr. Davidson?

Mr. DAVIDSON. Well, we certainly will look at it. We have a working relationship with the commodities future trading corporations, the FTC, and have asked them to help us in the development of our products, and of course some of these things that you are talking about have to do with commodities exchanges.

Mr. SMITH. You know, Dr. Collins, the other area of reducing risk for farmers is having a better idea of what the production needed is going to be. We now have the capacity if we would utilize it, and we could, we now have the capacity if we were to utilize all of our military satellites, for example, of examining the moisture, examining the growth of crops throughout the world. Especially I am thinking of soybeans in the Southern Hemisphere. And before planting of beans up here, we could come up with a very accurate—well, a deviation of the estimate is a deviation of plus or minus 70 percent of the production of those crops throughout the world. We were doing it during the Cold War. We have the ability to do a better job examining where forests are going to suffer and where crops are going to suffer. Maybe we could look at that, too. I don't know.

Mr. COLLINS. Well, we don't want to get so good at that that we know that we are going to have a loss before sales closing date. That is a joke.

You make several very good points, Mr. Smith. The first one is on forward contracting. As Mr. Davidson said, ARPA gave us a tremendous authority at the USDA, and that is to offer trade options.

Mr. SMITH. I have got to get a last quick question. In the 2000 bill the committee accepted my language that said USDA should refigure and restructure premiums on a regional and State basis, based on actual risk. What is the status of that?

Mr. DAVIDSON. I just sat down with our people day before yesterday to look at a comprehensive rate adjustment, and that is being done.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Smith.

Mr. Pomeroy, the gentleman from North Dakota.

Mr. POMEROY. Thank you, Mr. Chairman. Let me begin by saying it has been my pleasure to work with Director Davidson in his prior capacity in the private sector, and I have enjoyed working with him, have the highest regard for his skills and abilities, as with Associate Director Byron Anderson. I think that RMA has really got some significant strength, and I also like the outreach initiatives underway.

I last saw Associate Director Hatch at a listening session in Bismarck, North Dakota. In fact, Mr. Director, I understand you were at the listening session in Miles City, Montana, is that correct?

Mr. DAVIDSON. Well, I didn't attend there but I was born there.

Mr. POMEROY. Oh, you were born there. Hatch was saying he was at the listening session in Miles City which coincided with the bucking horse sale, and we were surprised we ever saw him again actually after the coinciding of those events. Thank you for coming up. I really do think that is a very important, certainly more than good PR, although it is great PR to get out and talk directly with stakeholders. I think you will find, as I have found over the years, that there is tremendous value in the give and take directly on how we can continue to improve this program.

I agree with Dr. Collins' comments that the role of crop insurance has changed over the years. Two major reforms, one in 1993, one in 1999, have really expanded significantly the participation in the program. One of the things Dr. Collins put a little in perspective, as we look at indemnify payments going from $1 billion to $3 to $4 billion, hopefully $3 billion on a normal year, we also are receiving significantly greater premiums, correct?

Mr. COLLINS. Absolutely.

Mr. POMEROY. So the net isn't a $2 billion hit every year, although let's face it, by trying to get people better coverage so that the coverage better reflects the financial risks they have, the indemnity payment size is going to go up?

Mr. COLLINS. Absolutely.

Mr. POMEROY. Well, I have got a couple of questions. This room is full today, but some of the faces that I have long seen in these crop insurance hearings aren't here anymore because their companies aren't here anymore. We have seen a fairly significant—in fact, by my view, alarming consolidation of the industry, leading to a point where we worry about capacity issues in North Dakota. First, Mr. Director, on the issues of, you know, are there enough players any more to ensure a stable marketplace, what are your thoughts?

Mr. DAVIDSON. I do think there are enough players to ensure a stable marketplace. There are a couple of things happening that I think will determine the continuing availability and capacity in the marketplace. One is something that is well outside of our control and that is what is happening generally with reinsurance throughout the world. This program is a small piece of what reinsurance companies take on for risk throughout the United States and the world, and it competes with other sectors of that industry. The continued interest of the reinsurance community in this sector of risk is a very important thing because about half of our companies rely solely upon reinsurance for their capacity to write business there. The others do have some net worth that they commit to the program, but they too rely upon reinsurance for major catastrophic levels of loss.

There are very good companies, very experienced companies within this industry. When a company fails, typically the employees go over to another company, and so the human capital I believe is there. Whether or not it exists in company A or company B is a question of the capacity and the ability of that company to be managed well. And there are some concerns with regard to continuing expenses in this industry. There is a lot of pressure, pressure in that area.

Mr. POMEROY. You believe that the capacity is going to improve, that this was part of the natural dynamic of the hard market that afflicted the commercial lines and all that?

Mr. DAVIDSON. Yes. I think you will see the cylical nature of this market will wax and wane.

Mr. POMEROY. We are compounded in North Dakota, Mr. Administrator, with a fairly low assigned risk number, and note that in Montana it is about 75 percent. Ours is about 45 percent. I have heard some indicate that without relief on that 45 percent figure we will have a localized capacity problem even if national capacity improves. Do you have the ability to evaluate whether or not these things should change over time?

Mr. DAVIDSON. We do have the ability to evaluate. We don't have the ability to change them without renegotiating the standard reinsurance agreement, and that has been a constraint. We only get one time in 5 years and then no other opportunities to renegotiate that. So we probably need some flexibility to be able to adjust more frequently to those trends that are affecting your State and other States.

Mr. POMEROY. The final question, if the chairman will give me leave, would be relative to the budget recommendations as to allowable administrative expenses. I remember when it was over 30 percent. Now 24.5 percent the administration's budget recommendation, 20 percent. One of the things we have always hoped with this program is that in the sales process we were also buying ourselves some risk counseling because of the new products, the higher indemnity opportunities, the huge financial stakes for the farmers. This is tough business, and it is important that they understand fully the products and how they may be protected. Do you believe that at 20 percent we can still get the job done in terms of delivery of this program in a way that meets the farmers' needs?

Mr. DAVIDSON. I think it is possible, but I think real savings measures have to be put in place. Simply to constrain the reimbursement doesn't mean that you have achieved real savings, and I think we can work together as an industry to figure out those savings.

Mr. POMEROY. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Pomeroy. By popular demand, if you don't mind staying a while longer, a number of members have additional questions and we will try to do a very brief second round. It is my understanding there are votes on the House floor between 11:15 and 11:30. So we have another panel. We would like to at least get started before that occurs.

Mr. Peterson.

Mr. PETERSON. Part of the problem we have had with the weather up in our part of the world is that we have been trying for 20, 30 years to implement some water control projects and have been stopped by the environmentalists and our own DNR, and so forth. Very frustrating situation.

Very frustrating situation. Now, what is being looked at seems to me it may be one of the best options that we have looked at and that is tiling the Red River Valley, which has never been done before. Down in southern Minnesota when they had a similar situation, they tiled that land and substantially reduced their risks. We have had people come in—and there is some tiling that has already happened—but once tiling came in, bought 160 acres and increased the gross income the first year from $52,000 to $95,000 just by tiling that land.

My question is if that came in and tiled this land and it makes that much difference in income, is that fact, is there some way that you can get credit for that in the crop insurance system, or do you have to wait 5 years until you have proved up these yields so that you can accommodate this increased yield and the change in circumstances? Is there some way that you can get credit if you, you know, cost 3 or 400 bucks to file your property per acre, but you are going to reduce your risk and increase your yield? Is there some way that you can get that into the system right away, or do you have to wait the 5 years?

Mr. DAVIDSON. It is fairly challenging to prospectively rate what risk reduction will come out of any particular risk reduction measure. I am not familiar with tiling itself. But I would say that under the current system we really try to reflect actual experience in the rating structure, and there is not a whole lot of opportunity to kind of prospectively say you did this and therefore your risk is lower.

Certainly something that we could look at. But the current system really isn't geared to do that.

Mr. PETERSON. Thank you. If we could, I would like to maybe have some discussions with you.

Mr. DAVIDSON. I would be very happy to have discussions with you.

Mr. MORAN. Mr. Smith.

Mr. SMITH. Are you examining the adjustments for, if you will, marketplace motivations to maybe put more pressure on the insurance adjusters as the insurance companies, with some going broke—I am not sure what the balance is to make—to have better incentives that they scrutinize claims or we develop ways to evaluate those claims to make sure that the fraud and abuse is minimized? There is a balance there some place. You don't want to go too far.

Mr. DAVIDSON. You don't want to go too far and do persecution rather than prosecution, as I mentioned earlier. We do have a fraud-training video that we provide to loss adjusters that I think has been very useful in bringing some commonality and some wisdom to the loss adjustment procedures. We regularly provide claims advisories out to the loss adjusters when we see something kind of emerging. And the availability of loss adjusters in major disasters, that kind of a situation is always a problem in the insurance industry. But in this last year we found that farmers really aren't having to wait too long to get their losses adjusted. I don't know if that is responsive to your question.

Mr. SMITH. Yes, I mean, with us sort of guaranteeing the administrative costs, they get their salaries pretty much guaranteed.

Dr. Collins, any reaction?

Mr. COLLINS. Mr. Davidson made a point earlier when asked about the capping of administrative and operrating expense reimbursement at 20 percent. Just us putting a cap doesn't necessarily stop companies from putting up what they are going to pay agents, for example. I think this is part of the whole financial oversight, monitoring and working with the industry that Mr. Davidson has embarked on to try and achieve greater efficiencies out of the whole system. Surely Congress had in mind that would happen under ARPA. There are a number of provisions under ARPA to try and promote competition in the delivery of the products; the Crop1 Premium Discount Plan came in under one of those provisions under ARPA. So there is a lot of attention being paid to that over the last couple of years. I think it is an area we are going to focus on over the next few years, particularly with the failure of American Growers and the concern over the various cost components of delivering crop insurance today. We have to have more discipline in oversight.

Mr. SMITH. Has there ever been discussion on the possibility of going back to the way we used to do it and have the ASCS, the farm service agency?

Mr. COLLINS. No, thank heavens. I personally don't think that is a prudent thing to do. We have moved the whole Federal Government toward competitive sourcing. We have an industry throughout that is competitive. Mr. Davidson just referred to the capacity of those industries. Sure, there are concerns. We have seen a dramatic drop in the number of companies. The market share of the top four companies is maybe 75 percent of the market now. Regionally, you worry about concentration when the industry has changed so dramatically. Nevertheless, I believe at this point we have viable and vigorous competition in the crop insurance business. We have a private sector structure out there to deliver these products. And as long as you have a competitive private sector, there is no market failure; there is no reason for the Government to take over those functions, I believe. In this case we have a regulator, that is, FCIC and RMA. It is the role of the regulator to ensure that there are no abuses in that system. But I think that we can do that with a private sector delivered product.

Mr. MORAN. Mr. Smith, your suggestion that you are have one short question, you are losing credibility with me.

Mr. POMEROY. I have a short one.

Mr. MORAN. I am sure you do, Mr. Pomeroy.

Mr. POMEROY. Quality loss, we have found in North Dakota farmers losing the economic value of their crop in a situation where they still have bushels. So the conventional coverages have not fairly covered this financial exposure that they had. For that reason, RMA was directed to develop quality loss coverage superior to what has been offered in the past. And the farm bill actually put a time line of 2004 on the completion and implementation of that new coverage. I am just wondering how that project is coming and what you can share with us in that area. It continues to be something very important, especially it is probably raining today in North Dakota. In these wet circumstances we are dealing with scab and all kinds of diseases on small grains that take their value away when sold. But, again, it is not a compensable item.

Mr. DAVIDSON. Well, I appreciate that. I have a concern as I listen to producers throughout the Nation, not just for commodities that are grown in your State, but quality adjustment issues and apples and wheat and a variety of commodities. Some of these things are pretty tough to follow and tough to figure out and particularly to price appropriately. We have had a study ongoing to try to address that, as ARPA dictated and the farm bill reemphasized. I have to say that we are struggling with it frankly. We are trying to make it work. But there are some real challenges with that. We would love to have some of your ideas.

Mr. POMEROY. I would be very interested in engaging in discussion with you on it. It is a situation that has a market dimension as well. It depends upon how much of the disease you have in an area, how large the price discount will be. I know in the past RMA has thought they are not insuring the farmer, they are insuring the grain trade. That is not how I see it. The farmer at the end of the line is taking the financial hit. So there ought to be some way we can give some coverage there.

Mr. DAVIDSON. It is complex and elusive.

Mr. POMEROY. The clock is running, and we need to come up with something. Thank you, Mr. Chairman.

Mr. MORAN. I have a couple of questions, which is why I agreed to the second round of questioning. I will just suggest a couple of things and we can talk about this later, but any announcement suggestions for the reinsurance agreement negotiations time frame? Where are we?

Mr. DAVIDSON. Last year we deferred the renegotiations. There was too much going on, the failure of AMAG and a number of other issues that we were working through. We felt like we needed more time to do it right. This year we feel like we have bought another 6 months. As you may know, we can go up to December 31 to announce, and then we have 180 days to finish by the July 1 deadline. We think that within a month we will probably announce and begin working with the companies in the early preparations of renegotiating the standard reinsurance agreement. We have quite a bit of preparation that we have done. The companies themselves, we understand, have also been preparing and thinking about the issues. There are a few kinds of broad issues that still have to be addressed before we start. But about a month; and then we would have, frankly, a year to get it done. But our goal would be to have it done by about November.

Mr. MORAN. Thank you. A number of constituent inquiries concerning the Premium Discount Plan is out there, are out there, certainly to us as Members of Congress, I assume to you. We have raised some questions with you about the approval process, and I would like to pursue that further with you.

And finally, Congressman Lee Terry of Nebraska has asked me to deliver to you, which I am happy to do, a letter that he would like your attention dealing with the book of business of American Growers and a potential sale of that business. And at the end of this meeting, I would like to hand that letter to you on behalf of Mr. Terry. I appreciate your testimony, Mr. Davidson, Dr. Collins.

We will now ask our second panel to come forward.

Mr. Ronald Brichler, who is the chairman of the American Association of Crop Insurers. He is the president of the crop insurance division of the Great American Insurance Company; and Mr. Jim Brost, the vice chairman of Collins Associates. Mr. Brichler is from Ohio and Mr. Brost from Minnesota. We welcome both of you to our subcommittee. And I was going to try to remember who has done this before. Mr. Brichler. We will take your testimony first.

STATEMENT OF RONALD BRICHLER, CHAIRMAN, AMERICAN ASSOCIATION OF CROP INSURERS, PRESIDENT, CROP INSURANCE DIVISION, GREAT AMERICAN INSURANCE COMPANY, CINCINNATI, OH

Mr. BRICHLER. Thank you, Mr. Chairman. Since you have done such a nice job with the introduction, I will pass that part of my testimony and also ask that the full text of my testimony appear in the record.

Mr. MORAN. Without objection it will be.

Mr. BRICHLER. While it is my intent to provide an overview of the financial health of the industry, I can only comment on specifics to my own company, but I would be happy to talk about goings on in the industry. I also intend to highlight just a few of the unique characteristics of the Multi-peril Crop Insurance Program.

As has been mentioned before already today, the crop insurance program is a very successful partnership between Government and the private sector, and it provides financial assistance to farmers when they experience losses. The companies that deliver MPCI are committed to providing an efficient and effective risk management tool to producers. And you have already heard this year that we have provided over $4 billion in claims to farmers. As in any given year, weather conditions are always unpredictable; and we suffered through severe draught situations; and now in some parts of the country, we already have severe rain which is impacting planting progress. So each year brings us new challenges.

You might ask why some of the companies are leaving crop insurance. One thing I would like to dispel very early in my testimony is that the companies that write crop insurance business are not guaranteed a profit. To survive and be successful, they need to manage their risk and their experiences just like farmers do. Ten years ago, there were 64 crop insurance companies. Today there are only 17. Just last November we lost the largest writer of crop insurance, American Growers. And this company was at the time writing $600 million in crop insurance premiums. Recently, the third and fourth largest writers of crop insurance announced they were going to merge their business. So in less than 6 months the industry will lose two of the top four companies servicing the program. As far as I can see, there aren't other companies lining up to get into the business.

You might ask what are the reasons for this. Well, the biggest reason is uncertainty. And it comes in three ways in the program. First, there are annual threats from the executive branch and Congress to cut administrative and operating expense reimbursement or to cap underwriting gains through the SRA. Second, the increasing complexity of the program, we have new products and program changes every year to deal with, and they present challenges. Third, each year we have the uncertainty of whether the Government will attempt to change the terms of the standard reinsurance agreement and in particular the gain and loss sharing formulas in that agreement. And these all on an annual basis bring financial uncertainty to the companies and their reinsurers.

First let us talk about administrative and operating expense. Exactly what is it? As was brought up earlier today, in most lines of coverage the premium charged goes for underwriting expenses, loss-adjustment expenses, and pure loss costs and profit. In this program, the administrative and operating expenses are supposed to offset the underwriting and loss-adjustment expenses of the company. We have heard numbers and percentages kicked around today. And currently by legislation, the A&O is capped at 24.5 percent. But it is capped at 24.5 percent of a loss cost, not a total premium. So when you are comparing ratios in the industry between crop insurance and other lines of property and casualties coverage, you need to adjust ratios.

In today's marketplace, the underwriting and loss-adjustment expense for all lines of property and casualty coverage are approximately 38 percent. We have heard today that on a loss cost basis only, only 21 percent of the A&O currently is 2 percent. So the amount that is being reimbursed to companies is significantly lower than the industry average, and it is significantly below the cost of companies to deliver that product. In addition, ARPA has increased our cost of doing business. It has been very successful at increasing coverage levels; and, therefore, higher coverage levels means higher claims frequency, as you can see by the graph in my testimony. But higher frequency also means higher frequency of claims, and therefore we have more expenses in the loss-cost area.

I mentioned program complexity. Every year we have new products that we are required to train our agents on and to give justice to as far as explaining it to producers. Since 1997 there have been 200 manager bulletins released relating to changes in the program.

During ARPA implementation, the Risk Management Agency was afforded funds to help in that implementation. However, the cost to the companies was not reimbursed; and we did that because we had to.

Finally, let me talk a little bit about the SRA. As we have heard earlier, that is going to be renegotiated and companies look at that SRA document as a total package. The administrative and operating expense reimbursement, the potential for underwriting gains and the risk-sharing formula, if you can think of those as difference cylinders, if you push down on any one of them, the pressure has to go some place else. So from a renegotiation standpoint, we can't push down on all of those at the same time and expect the industry to remain healthy.

One other thing that I would like to bring to the committee's attention today is the fraud and abuse issue. We have had some recent publicity on this. And insurance fraud is the second most committed fraud in the United States, second only to tax evasion. It is something that we struggle with every day in the property and casualty business. And crop insurance is not immune to this. However, every claim that is paid by a crop insurance company is partially out of their own pocket. So, therefore, we have every incentive to make sure that claims are paid correctly and appropriately as far as dollars.

As far as oversight, companies are required to perform 13 different audit-type transactions on their business throughout the year. In addition, ARPA has strengthened the mechanisms that RMA has as far as sanctions, and we see that as helping out immensely.

In conclusion, thank you for allowing me to appear before you today. The companies that I share this industry with are all committed to making sure that farmers have secure risk management in the crop insurance arena. We would like to work with both Congress and RMA to simplify the program. If we simplify it, it will reduce costs to all parties. And also we would ask that you all join us in helping to stabilize the program and not to make drastic changes to the industry which would ultimately impact our reinsurers and the health of the industry.

And with that, I thank you, Mr. Chairman. I will be available for comments.

[The prepared statement of Mr. Brichler appears at the conclusion of the hearing.]

Mr. MORAN. Thank you very much, Mr. Brichler.

Mr. Brost, welcome to the subcommittee.

STATEMENT OF JAMES A. BROST, VICE CHAIRMAN, JOHN B. COLLINS ASSOCIATES, INC., MINNEAPOLIS, MN

Mr. BROST. Good morning. Thank you for the invitation to appear and a special hello to my fellow Minnesotan. I am Jim Brost, vice chairman of Collins Associates. We are a Minneapolis-based reinsurance intermediary.

Let me first clarify what reinsurance is. It is a commonly called insurance on insurance companies. It is a transfer of risk from an insurance company to an assuming reinsurer. There is a cost for this risk transfer. My role as a reinsurance intermediary is to meet with the reinsurers and bring their support behind the insurance company writing the business.

We have heard many discussions about the standard reinsurance agreement. And there are a whole myriad of items included in the SRA. I am addressing the part dealing with the gain/loss formula, the profit/loss, gain/loss formula, if you will. A perception seemed to exist out there that the SRA provides all the reinsurance needs of the companies writing the business. It does not. And I need to repeat: the SRA does not meet all the reinsurance needs of the

MPCRX. Now, what they have done is they go out and buy what we might label here as “commercial reinsurance.” and why? This either allows them to expand their operations or maintain their capital base. Both of those are necessary in order to, can I say, complement their ongoing viability. In 2003 the MPCI writers purchased something around $1.5 billion in commercial reinsurance. And again, this $1.5 billion is on the risk remaining after the SRA reinsurance applications.

As I said earlier, there is a cost for this reinsurance. And those costs have risen in recent years. Certainly the drought-related losses of 2002 are impacting those costs. But there are also factors outside the MPCI industry that are influencing the reinsurance world in which we must compete for reinsurance capacity. The reinsurance community obviously was heavily impacted by the World Trade Center losses. You perhaps have read recently where asbestos claims, Worker’s Compensation, those type of claim reserving practices are going on that are impacting the reinsurance companies’ results.

Earlier, somebody referred to the economy’s performance also as an important part. A reinsurance company can cushion poor underwriting results by investment income. Needless to say, investment income has not been too terrific as of late. When we go into the market with a reinsurance program, the assuming reinsurer will analyze it for what is called return on equity, ROE, or chances of profitability, et cetera. That ROE target that we talk about within MPCI is then compared to the targets established in the property casualty reinsurance world. I would suggest today that today’s MPCI program has faded somewhat in this comparison of the ROEs in part because those ROE expectations in the, can I call it, commercial property casualty world, reinsurance world, have increased.

Now, we have had some reinsurers who have reduced or withdrawn their support of MPCI, but there has been sufficient supply in order to meet the MPCI’s industry’s needs. I would be conscious of this future capacity if two items are pursued to any great degree: one, a reduction in the A&O, administrative and operating; and, two, a revision in the SRA reinsurance parameters which could impact the underwriting profits to the companies.

One of the basic premises of reinsurance’s continuity, acting as an amortization vehicle, if you will, if they perceive that a certain entity will not be around in a near and longer term, they may determine that they do not want to support that operation. That can be both from an operational perspective; and, two, if the SRA is changed where the future risk reward scenario is altered arbitrarily, that will affect a reinsurer’s decision.

This business is very esoteric. I can tell you from my extensive travels that to get a reinsurer on board to follow the MPCI business, it is extremely difficult. “Keep it simple” is one of the requests that is always received by me. There is a perception out there in the industry, in this room here perhaps, that there have been substantial profits in MPCI. If there have been such substantial profits, then why have the number of reinsurers supporting the MPCI diminished? Some of that is going to be due to mergers and acquisitions admittedly. I would suggest that the ROEs are not sufficient to keep people's interest.

In closing, we would ask the question: What happens if the industry suffers another loss? Well, clearly the costs of the reinsurance will be increased from the commercial world. It will in part be influenced by what happens outside even the MPCI world. If we have a bad property casualty environment out there, there will be increased pressures for ROE increases.

As we sit there and look at the business today, we are $1.5 billion, as I said, in MPCI purchasing; that is against a reinsurance industry that is buying, by some estimates, $750 billion. We have to be cognizant of what are the outside pressures, if you will.

Again, thank you for the invitation. I might suggest that, and request respectfully that, my full written presentation be incorporated for the record; and I am happy to answer any questions you may have.

[The prepared statement of Mr. Brost is on file with the committee.]

Mr. MORAN. If there is no objection, it will be. Mr. Brost, thank you very much for your debut appearance. I appreciate it very much.

Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman. I am kind of curious about how the oversight works over at the industry and how we got into this situation with American Growers. Can you characterize the ability of RMA to recognize financially stressed reinsured companies? And what kind of improvements need to be made in the oversight process so this doesn't happen, can be avoided if possible?

Mr. BRICHLER. I believe that the procedures are in place. The way the process works is an insurance company or reinsurance, what we call reinsurance providers in this case, we are required to file a plan of operations with RMA in April of the year that we first write a policy in July. So there is an amount of time that we file our intentions and support those intentions with our financials and, you know, what we plan on doing. RMA has, I think, sufficient time to review that. I believe in going forward with the experience that we have had with American Growers, that there is going to be a high degree of scrutiny of that information. We have already received a number of additional information requests that we have not had to deal with before with RMA. And I know, based on a meeting earlier this week, Mr. Davidson said that he is setting up a separate group of individuals that will dedicate themselves to reviewing that financial information. So I believe the procedures are in place, and I believe they will be able to do a decent job of reviewing financial strength of a company.

Mr. PETERSON. As I understand it, last September RMA testified that at the time its belief was that no crop insurance companies were in financial danger; that Mr. Davidson, I guess, noted at that time that there was some financial strain to be anticipated for 2002; but as of September, RMA testified that they hadn't seen any of the quarterly reports from the companies. So is that still the situation? I mean, it seems like with what happened with this situation, it didn't really work.

Mr. BRICHLER. Unfortunately, I am not familiar with his testimony on what he said. I know that from our particular company that we have publicly filed financial statements since we are a publicly held company. So I am not positive what the nonpublic companies have as far as reporting requirements to RMA. But I can certainly find that out, get you that answer.

I think the American Growers failure is something that is very attuned to that particular company and their management. You have heard earlier today that Mr. Davidson referred to other strong companies in the industry and their management. And I am a firm believer that there are strong companies with management-knowledgeable individuals to continue on.

Mr. PETERSON. Mr. Brost, do you have any comments about this topic?

Mr. BROST. No, sir.

Mr. PETERSON. Apparently the administration has proposed that the rate of reimbursement paid to companies for administrative expenses be reduced from 24½ to 20 percent. What do you think about that, and what is in your opinion the correct amount a company should be reimbursed for A&O expenses?

Mr. BRICHLER. The last part is probably the most difficult, but let me get the first part of your question. The 24½ percent, for one thing, is not the correct percentage because the 24½ is what is in the legislation. The CAT policies, and also those policies that have revenue coverage, are reimbursed at a lower level. So if you look at the total book of business that the industry writes, the average A&O reimbursement is closer to 21 percent. So if you change the legislation to state that it is 20 percent and you do that same math, that ratio is reduced to about 17.8 percent overall.

Earlier in my testimony, you heard that the property and casualty underwriting expenses for loss adjustment and underwriting, which is what we do on behalf of the Government in this program, is 38 percent of the premium. And the premium is a fully loaded premium, not only the loss cost that we are talking about in the crop insurance program here.

Some of the polling that we have done in the industry has led on a composite basis to an indication that the companies are actually spending 28 to 29 percent in administering this program.

So in answer to your final question, I think it should be considerably higher than it is today. Now that the drive, as Mr. Davidson said earlier, is to find out ways that we can all save money in the program and the simplification and making things easier is obviously what we need to attack there. And everyone will save in that regard.

Mr. MORAN. Thank you. Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. I have got a couple points on both sides of this question. I would say to you, Mr. Brichler, that you indicated that ARPA increased the work for the insurance industry without increasing the costs they were reimbursed for under the percentage; but on the other hand, the Federal Government was providing a much more significant subsidy behind the premium so the percentage you were getting was of a higher premium as people increased the buy out; isn't that correct?

Mr. BRICHLER. The premium is always a function of commodity prices. The last time I appeared before this committee, we were talking about the crop insurance companies being reimbursed based on the premium that people were projecting because crop prices were supposed to go higher. Well, they have gone lower for the last 5 years in general, and so therefore what you are saying is absolutely true as far as the premium will increase as people buy up; but we have also had offsets in the fact that the total premiums that developed in the program are much lower because the cost that we are insuring in the liability drops as crop prices drop.

Mr. POMEROY. Fair point. A lower price selection will drop and offset the higher percentage of costs. I understand that.

Mr. BRICHLER. The other issue on expense is, as I mentioned, as claim frequency rises because you have people selecting a much smaller deductible, at the 85 percent level, for instance, you only need a 16 percent loss there to incur a loss; so therefore from a company perspective, we have a much more or higher number of claims that are filed and claims that we need to adjust.

Mr. POMEROY. That makes sense to me. You talk about the uncertainty, the cloud of the SRA renegotiation hanging over, maybe discouraging companies from entering the market. On the one hand I do understand the point in that if you are going to build a distribution system and product design and all of the rest of it, a lot of expense that you are going to put into a product, if the economics are really kicked out the door with an SRA renegotiation that comes out unfavorable from the industry's perspective, it will be a sum cost wasted. However, when was the last time we established the SRA?

Mr. BRICHLER. The gentleman back here might know, but I think the last time was 1994. Does that sound right? 1997, 1998 crop season.

Mr. BROST. The present form was adopted in 1998.

Mr. POMEROY. My thought is, and I strongly supported this provision of ARPA, is at some point—once in a while you need to look at this and have an opportunity to evaluate whether or not there is—based on marketplace activity, we are cutting too rich a deal, not sufficient a deal. I think that RMA made the right decision in foregoing this year as a renegotiating year in what is happening with the marketplace with the exodus of participants.

And in the end, we hear an awful lot in this committee and, you know, in evaluating whether or not facts support the assertions, the marketplace is really the ultimate arbiter of all of this. This is a marketplace showing exiting of the business, insolvent companies, diminishing capacity. So thoughts that we are overcompensating our private sector partner or that at this hour we can take the percentage down another 4 or 5 percent really are not borne out by market experience. You don't have in the fully private insurance sector at a time of loss and insolvency reinsurers, you know, taking an even greater pound of flesh out of their primary writers.

It would seem to me this committee has to pay—this committee and RMA—and I am very glad Administrator Davidson stayed for this panel, which is unusual, usually you will have the agency head talk and then leave. I think, again, that shows that they are a listening group over there. But we have to pay attention to the shrinking capacity of the marketplace as we decide where to set these reimbursement levels.

Mr. Brost, do you have a comment on that as an intermediary?

Mr. BROST. I guess I would make one clarification, Congressman. You say shrinking capacity, maybe we have to refer to that in terms of number of entities in the reinsurance world. I don't necessarily want you to assume that that means, in fact, the capacity that the market affords. Don't infer that it is not sufficient to meet today's needs.

Mr. POMEROY. I do. As an intermediary, you are not being worried about being able to file in the reinsurance sector the support you need for the primary risk written?

Mr. BROST. Well, today. And again, we have got sufficient capacity today to meet the needs. If the revisions are made in the A&O and/or the SRA, the question is what does that have for resulting ramifications for future reinsurance capacity. I would say there should be an awareness as we are kind of like Let's Make a Deal: We have come out from behind a curtain, us people in the reinsurance world. We have always been there and created the necessary support.

The reduction in the A&O, I have been placing reinsurance since 1976, and I remember in 1988 we had something upwards of 56 companies writing MPCI business. And in those days, I believe the A&O was something in the area of 34 percent. You just check this out and there has got to be a very direct correlation between two things: one, the reduction in the A&O; and, two, the Government's movement to change the economic mechanics of the gain-loss calculations, if you will. Both of those in concert, I think, are directly contributing to what was once a 566, and we are down to 17 or something like that today.

Mr. POMEROY. I thank you. Very, very interesting panels.

Mr. MORAN. Thank you very much. Mr. Osborne, who is not a member of this subcommittee but a member of the full committee, has joined us. I am glad for that, but it takes unanimous consent of our subcommittee to allow you to be seated here and ask questions. Is there any objection? Mr. Osborne without objection you are recognized.

Mr. OSBORNE. Thank you. I have got three questions. I am sorry I couldn't be here for Mr. Davidson's testimony. Maybe these have been asked before. We really have three major concerns in our area. One is what do we do about multiyear drought. Because as the drought goes on, the farmer can purchase less insurance. And, actually, that just exacerbates the problem. So any suggestion you have in that area.

Second, you prevented planting, a lot of people who knew in advance to some degree that they weren't going to get much water, the reservoirs were low and they were debating whether to convert to dry land or try to irrigate again. We had all kinds of finger-pointing. Some people pointed at RMA, some at the insurance companies, and some said the FSAs. And I am sure they all shared in the problem. But we had a lot of people who simply could not get an answer. All they needed was an answer because they need to know what to do.

The third question is speciality crops. If you are going to try a different crop in an area that hasn't been tried before, you need a history. You can't get a history if you don't have insurance. So it is circular. So we can't get anybody to try a speciality crop if they have no history and they can't get insurance. So I have thrown a lot at you. I am assuming that Mr. Brost probably would be involved in this reinsurance. If you want to take a shot at that, I would appreciate if either one of you could give me a response.

Mr. BRICHLER. Congressman, I think you have attacked probably three of the most difficult problems that we have in the industry collectively between RMA and the private sector. Let me take the multiple year loss situation first. One attempt to, at least in that regard, was the T-yield plugs that were put in place. I realize that a 65 percent T-yield plug doesn't help a farmer on long term. As you said, they end up in a death spiral as their yield guarantees continue to decrease. I know that RMA is doing their best to look at that. As companies, we deliver the products as they are given to us. So we need to collectively work with RMA on that. We do not have an answer for that, as Mr. Davidson said earlier.

Second, you mentioned the list of speciality crops. That might be your third part, but it is the second one I remember. Again, in an attempt to address the specialty crop area, I think generally what RMA does when they look at new product development is they look at the amount of acreage or amount of customers that they can attack on a product-by-product basis. So, therefore, those products that cover the most acreage or have the most impact to the highest number of farmers, they have been addressed; and we are at basically an 80 percent coverage level across the United States as far as acreage planted.

Where it becomes difficult is when you get into situations like the Congressman before from, I believe, Idaho was talking about having 150 different crops. Where the industry and RMA have started to try to address this is through some pilot programs, and in particular one of them is AGR, which is adjusted gross revenue. There you can protect the revenue of the entire farm versus specific crops. It is not perfect. It is only a pilot program right now. But at least it is an attempt for us collectively with the Risk Management Agency to kind of cut our teeth and see what we can do to help in that area.

And could you please repeat the third one, and I will try to get that one as well? Prevented planting. Prevented planting is probably the most complex part of the insurance policy that we see today. We need to simplify that. In that regard, RMA and the industry continue to meet with a joint committee to try to address prevented planting. It is a little bit more easy to deal with, as the Congresswoman over here said earlier, about if the land is drowned out, it is pretty easy to tell you can't plant there. But when it becomes a drought situation or a failure of the water supply or not having enough water for irrigation, it becomes much more difficult. We have struggled collectively with RMA to be able to come in with a broad-brush announcement that, yes, these areas are okay, they are going to be prevented due to drought. And that is very difficult. And I think we are getting better at that. But there is still a lot of improvement that can be made. And we in the industry continue to work with RMA on that as best we can.

Mr. OSBORNE. Thank you. I understand the pilot programs on, I think you said AGR or whatever, regarding specialty crops, I hope we can move forward with that. Because we really need to diversify. Right now the system seems to reinforce planting the same old crops we have always planted. It really gets in the way of profitability in many areas. So we need to do something that will encourage diversification and at least attempts to do some new things. We have a situation with chicory in the western part of Nebraska, which can be very, very profitable, as much as $500 an acre profit. But we can't get anybody to plant it because we can't get any insurance for it. So we are having to create our own insurance group, and that has been a difficult thing.

Thank you, Mr. Chairman. I yield back.

Mr. MORAN. Thank you, Mr. Osborne. We are delighted to have you join us. Appreciate your questions.

Mr. Brost, you heard the answer to my question to Mr. Davidson about the negotiations on the 2005 SRA. What are the consequences of that dragging out beyond a certain point in time?

Mr. BROST. It is probably a direct result of what the message is. If you are going to renegotiate the SRA and undermine the future profitability, reduce the profitability of it, publish the announcement as last as you possibly can so that people looking at the 2004 reinsurance aren't unduly affected. If you have got some stable or good news on the SRA negotiations for profit or loss, then I would say get it out as quickly as possible. This is a moving target you have asked me there. But, again, what is the point in waiting? Let's get it out. That there is a lot of education and modeling that is going to have to be done if there are revisions in the SRA. Those meetings have to be held.

Mr. MORAN. Your testimony, and I quote, "I would suggest the ROEs have not been sufficient to maintain the reinsurance's interest." What are the components of that ROE? What factors are there that we should be paying attention to that determine the ROE?

Mr. BROST. Well, when you look at ROE from an—or anybody's perspective, the most elusive one is the denominator. What are they throwing in there in all of their calculations? Once upon a time, the corporate world was saying give us top-line growth. Well, now ROE is a popular word. What you don't see people manipulating again is what the denominator is. Fundamentally, it is how much capital do I need to allocate to support the risk on the business. If it is a capital allocation issue, premium comes into play. Frankly, while we don't need to get Ron to speak to specifics, ROE is fundamentally what do I have to submit to the business in order to stay within industry loss ratios in order to create a certain profit. And that will give me my end result. Ron might speak to that better than me.

Mr. BRICHLER. I will give it a shot. From a property and casualty company standpoint, which Great American is, writes all lines, what we look at and Jim identified correctly the denominator is the equity; what amount of capital is required for us to support the amount of business that we are writing. Now against that, we need to judge the return on our invested assets, the return on that surplus, that capital that we actually are using to support the business. And the third component is the underwriting gain or loss on that business.

So crop insurance is a bit peculiar because, one, the companies do not set the rates; RMA sets the rates so therefore we can't raise premium rates when we feel it is necessary.

Two, the expenses are somewhat controlled as far as the reimbursement in the A&O are controlled by the SRA; so therefore from our perspective, we have to try to deliver the program as efficiently as possible, but we know we are not achieving 100 percent offset on that expense component. As Mr. Davidson said earlier, we don't get credit for the premium. Most of it is collected after the season to begin with. So we are usually upside down on delivery costs before we even start out off the bat.

So the only thing we have from a return standpoint on crop is our underwriting gain or loss. And so therefore we have to net that underwriting gain or loss against our expenses. And if that amount comes out positive, then we are going to have a return on the capital that we have.

Mr. MORAN. Thank you. One of the questions that I had anticipated asking you—I want to make sure—perhaps it has been answered, which is what have we learned, what should we learn from the circumstance that we find ourselves in with American General?

Mr. BRICHLER. American Growers.

Mr. MORAN. I mean American Growers. I think it was you, Mr. Brichler, your answer would be that the circumstances that that company faced were unique to that company.

Mr. BRICHLER. That is correct.

Mr. MORAN. So there is not a broad story to be told here for the industry, things that we ought to be concerned about.

Mr. BRICHLER. I would say that general lessons learned are—and I agree with Mr. Davidson—that we need to be cognizant as companies of our expenses. Any good business person would do that. That is one thing that obviously has seen the bright light of day based on what happened at American Growers. They had some other issues that were noncrop insurance related that also came into play in their demise. So from that perspective, it is kind of difficult to say, well, this is everything, everything that occurred there.

Finally, I think the thing that our company is very concerned over year in, year out is that even though we are a major stock company, we feel it is necessary to have our reinsurance partners walk hand in hand with us year after year. As Mr. Brost said, they are here to amortize bad years, and so therefore they also need to make money in the good years. And I think any company, whether it is American Growers or my company or any other, we need to make sure that we protect our company and our surplus through a prudent risk management on our own, which is the purchase of reinsurance in the private marketplace.

Mr. MORAN. My time has expired. I indicated to Mr. Brichler about the cost, the paperwork rules and regulations. That reminds me of my constituents, lots of complaints about how Government operates and the bureaucracy involved and the reality of that increased cost of being in business. What would be helpful, I think, to RMA as well as to us as Members of Congress is examples. It is hard for to us attack bureaucracy and paperwork and unneeded rules and regulations, too much involvement in your business by an agency. In general broad terms, what we will probably do is nod our head and say, yes, I am sure that is true.

But what is useful to us as policymakers, and what I think RMA would be interested in, is here are the specifics of things that we are required to do that really make no sense to us, lack common sense; here is the way to shorten the process; here is the way to make decisions more rapidly that ultimately result in cost savings to our company and therefore cost savings to our farmers and to the Federal taxpayers. Is that a fair request?

Mr. BRICHLER. I think it is, Mr. Chairman. We as an industry and RMA in the previous administration went through a painstaking review of the process of what we were doing through a panel that was developed jointly on simplifying the program. Now, Mr. Davidson has had a baptism by fire walking into his new task. And it is something that we have asked him to look at, all the work that was done with the previous administration under Mr. Ackerman. And there are some suggestions that were made and came out of that work that I think could help and simplify the program. It is going to be a never-ending battle. The regulations, as you can see in the Federal Register just in the policy language alone, if we probably stacked all the paperwork for the policy language and the provisions on this table, they would probably get pretty close to the ceiling. So it is just very paper intensive, and we just need to keep working on that collectively together.

Mr. MORAN. Thank you very much. I thank both of you for your testimony. I thank the participation and attendance of our subcommittee members. Without objection today's record of this hearing will remain open for 10 days to receive additional materials and supplementary written responses from the witnesses to any member of the panel. This subcommittee is now adjourned.

[Whereupon, at 11:52 a.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF KEITH COLLINS

Mr. Chairman and members of the subcommittee, thank you for the opportunity to be at today's hearing on crop insurance and risk management issues for U.S. agriculture. I currently serve as Chairperson of the Board of Directors (Board) of the Federal Crop Insurance Corporation (FCIC). My remarks today will focus on the activities of the Board since passage of the Agricultural Risk Protection Act (ARPA) of 2000.

ARPA made substantial changes to both the functions and responsibilities of the FCIC. In today's hearing, Mr. Ross Davidson, Manager of FCIC and Administrator of the Risk Management Agency (RMA), and other witnesses will discuss many of these changes, including:

- Expanding pilot programs to include livestock, a sector of agriculture specifically excluded in the past,
- Emphasizing service to underserved states, underserved crops, and underserved producers,
- Outsourcing the internal research and development of crop insurance products,
- Increasing risk management and crop insurance education and
- Expanding the role and the use of cutting edge technology, such as data mining, to increase risk management compliance.ARPA also changed the management of FCIC to facilitate the changes in priorities and the increased activity mandated by this new legislation. Prior to the enactment of ARPA, the Board of Directors (the Board) consisted of: the Corporation Manager; two Under Secretaries of Agriculture, one responsible for the Federal crop insurance program; a crop insurance profes-

sional not otherwise employed by the Federal Government; and three active producers who were policyholders and not otherwise employed by the Federal Government

Under ARPA, the number of private sector Board members has increased. The new structure of the Board is: the Corporation Manager as an ex officio non-voting member; two Under Secretaries of Agriculture, one responsible for the Federal crop insurance program; the U.S. Department of Agriculture's Chief Economist; one crop insurance professional; one member experienced in reinsurance or the regulation of insurance; four active producers who are policyholders from different geographic areas of the United States, and represent a cross-section of agricultural commodities, including at least one specialty crop producer.

The Board has met 31 times since enactment of ARPA in June 2000, compared to twenty-seven times from 1996 through 2000. Several factors contributed to this increase in activity, including the increased submission of private products under section 508(h) of the Federal Crop Insurance Act (Act), and the requirement that the Board use independent expert reviewers to assist in the decision making of the Board.

Section 508(h) of the Act authorizes the reimbursement of certain costs associated with the development and submission of products from persons outside FCIC. This incentive, along with the expansion of allowable commodities, such as livestock, has fueled an increase in the number of private submissions. The legislation also requires FCIC to make determinations on submissions to the Board by issuing a notice of intent to disapprove a product not later than 90 days and approve or disapprove a product not later than 120 days after receipt of a complete submission.

ARPA also requires the Board to contract with independent actuarial and underwriting experts for the independent review of policies, plans of insurance, and related materials prior to the Board giving approval for such products. In making its decisions, the Board must take the results of the expert reviews into consideration before its determination of approval or disapproval. Since the enactment of ARPA, over 150 independent expert reviews have been conducted on over two-dozen submitted products and program modifications. The Board currently has nearly forty expert reviewers under contract. The recruitment and retention of qualified expert reviewers is an ongoing task.

The Board approved several new risk management products over the past two years, including the Livestock Risk Protection (LRP) and Livestock Gross Margin (LGM) plans, as well as whole farm insurance policies such as AGR-Lite, and a Nutrient Best Management Practices insurance plan. New specialty crop insurance program proposals have been approved including caneberries and forage seed. The Board has also approved the expansion of certain pilot programs, such as the pecan insurance pilot program.

The Board generally delegates ratemaking issues to the Manager of FCIC. However, due to the magnitude of the potential changes to the rating structure of major FCIC products, the Board decided to be directly involved in the review of the rating methods for several products, including APH, Revenue Assurance, and Crop Revenue Coverage. This review may lead to substantial changes in the way most crop insurance is rated. The Board also reviewed Crop1's Premium Discount Plan and recommended its approval if the criteria in the procedure, created by the Board, were met.

As we look to the future of FCIC, the Board will be focusing on a range of issues crucial to improving the risk management capacity of farmers and ranchers. In order to ensure that FCIC's resources are used in the best possible way to meet the needs of producers and the industry, the Board has authorized a set of studies looking at the FCIC's current and future products. The first is a comprehensive review of policies, plans of insurance and related materials. This study focuses on any inconsistencies or overlaps between the program legislation, regulation and program materials. The second is an analysis of the FCIC product portfolio, with specific attention on coverage overlap and gaps. We believe this study will help the Board and RMA deal with the large number of pilot programs and feasibility studies that are in the pipeline. The results of both of these studies should give FCIC valuable assistance in developing a strategic product development plan.

The Board is also mindful of the statutory charge that "The management of the Corporation shall be vested in a Board of Directors subject to the general supervision of the Secretary." While the Board is very active in the general management of FCIC, the Board cannot and should not manage day-to-day activities and issues that continually arise in this complex program. That is the task of Under Secretary Penn and Administrator Davidson, and they are doing an excellent job.

In order for the Board to manage its considerable responsibilities of guidance and oversight placed on it by the Act, as amended by ARPA, the Board has created a committee structure to help ensure appropriate attention is given to the full range of issues the Board must address. Newly created Governance and Audit and Finance Committees are the first stop for many of the issues that need Board attention. For example, the Governance Committee is currently addressing the delegation of authorities from the Board to the Manager of FCIC. The Board expects its review and reformulation of the delegations to be finished this summer.

The Board is fulfilling, and will continue to fulfill, its statutory responsibilities, including the provision of oversight, guidance and direction to FCIC and RMA. The Board is committed to strengthening the nation's crop insurance and other risk management programs and the regulatory functions of RMA. All of the Board members are pleased to have the opportunity to serve American agriculture and all are working diligently to ensure this crucial part of the farm safety net functions as efficiently and as effectively as possible.

That completes my remarks. Thank you.

STATEMENT OF RON BRICHLER

Mr. Chairman, members of the committee, it is an honor for me to appear before you to discuss the status of the crop insurance industry. I am Ron Brichler, chairman of the American Association of Crop Insurers (AACI), and President of the Crop Insurance Division of the Great American Insurance Company, Cincinnati, Ohio. I respectfully request that the full text of my testimony be included in the record of these proceedings.

While it is my intent to provide an overview of the financial health of the industry, I, of course, cannot comment on the specifics of any company other than my own. I also intend to highlight some of the unique characteristics of the multi-peril crop insurance (MPCI) program.

The crop insurance program is a very successful government program delivered professionally by private industry. It provides timely financial assistance to farmers who have experienced crop losses.

The companies that deliver MPCI are committed to providing an efficient and effective risk management tool to producers. During the harvest season last fall, when loss claims peaked due to the drought conditions, companies moved loss adjusters across the Nation to expedite processing of claims—on average claims were settled in 15 days. To date, the industry has paid more than $4 billion in claims.

The widespread drought in 2002 tested the financial fiber of all the MPCI companies. We are bracing again for continued turbulent weather conditions as water shortages continue in the West and wet weather is keeping Midwest farmers out of the fields.

REASONS COMPANIES ARE LEAVING THE CROP INSURANCE INDUSTRY

I want to dispel one myth early on: MPCI companies are not guaranteed a profit just because the MPCI companies are in partnership with government. The companies are not assured any measure of profit.

Ten years ago, there were 64 crop insurance companies. Today there are 17. As in any industry, some consolidation is to be expected, but further consolidation and withdrawal of the companies from the market could jeopardize local service to farmers.

Last November we lost the largest writer of crop insurance, American Growers Insurance Company, which wrote nearly $600 million in crop insurance premiums. Negotiations are presently underway between the third and fourth largest companies to merge. When approved, Rural Community Insurance Services will take over the crop insurance business of Fireman's Fund. So, in less than 6 months, the industry will lose two of the top four companies servicing the program. Other companies are not lining up to jump into this business.The greatest reason for the loss of companies in the crop insurance industry is the uncertainty of dealing with the government. These reasons include: (1) annual threats from the executive branch and Congress to cut the administrative and operating (A&O) expense reimbursement to companies or to cap the potential underwriting gains, (2) the increasing complexity of the program—there are additional last minute regulatory changes each year which are difficult to implement and (3) uncertainty each year as to whether the government will attempt to change the terms of the Standard Reinsurance Agreement, in particular the profit/loss sharing parameters. Annually, these factors bring financial uncertainty to companies and their reinsurers.

Program Contains Unique Features. The MPCI program differs from other lines of insurance in many ways.

The following are unique features of the crop insurance program:

- Public-private partnership
- Nationwide coverage—all farmers in all states
- RMA sets all rules for the program
- RMA approves all premium rates—MPCI companies do not
- SRA caps amount of gain company can receive each year

The crop insurance program involves a private-public partnership between the government (Federal Crop Insurance Corporation (FCIC) through the Risk Management Agency (RMA)) and the crop insurance companies to deliver the program under the contract known as the Standard Reinsurance Agreement (SRA).

Perhaps the most unique characteristic about MPCI, compared to other lines of insurance, is that it is a nationwide program that provides crop insurance products to farmers in every state. Therefore, it has more risk variables than any other line of insurance.

Additionally, if a company chooses to operate in a state it must offer all crop insurance products to every producer in the state, regardless of the producer's claim history.

The RMA sets all rules for the program—not just the terms for delivering the products such as training and computer technology requirements, but also the premiums, terms for risk sharing and expense reimbursement. The risk sharing aspect involves up to seven calculations in each state the company writes business in. After all these calculations are complete, there is still sufficient risk exposure to companies in the program that most MPCI companies must go to the private reinsurance marketplace to mitigate potential losses in a bad year.

The SRA also caps the total underwriting gain a company can receive in any given year. If a company is fortunate enough to have a good year and makes an underwriting gain, the company may receive only part of the gain that year. Caps within the SRA may require the company to wait for up to two additional years to receive the full amount they are entitled to. However, the company is still required to pay expenses, including claims to producers in that current year. A year with a good return is necessary to build up reserves to carry a company through a year like 2002, with record levels of claims.

Present Threats to the Economic Viability of the Industry

Proposed Cut to A&O Expense Reimbursement. The A&O expense reimbursement is a subsidy to the farmer—because it reduces the premium paid for crop insurance. Unlike other types of insurance, crop insurance premiums do not contain an expense load to cover administrative and operational costs. Instead, USDA has subsidized the premium to the farmer by paying a set amount to the companies for an A&O expense reimbursement. This amount varies by the product sold but it is the same for all companies, regardless of their actual delivery costs.

The fiscal year 2004 budget included a legislative proposal to reduce the administrative expense reimbursement from 24.5 percent to 20 percent. Companies are not currently receiving 24.5 percent A&O reimbursement, meaning 24.5 cents for every dollar of premium for all crop insurance products sold. More popular revenue products and catastrophic coverage are reimbursed at a lower level than standard multi-peril crop insurance. The present average reimbursement rate is approximately 21.5 cents per dollar of premium sold. The proposed reduction would translate to an average rate of approximately 17.72 cents per dollar of premium, which reflects the different reimbursement levels for different products.

As a result of the Agricultural Risk Protection Act 2000 (ARPA), USDA reports enrollment in the crop insurance program has increased 17 percent, up from 182 million acres in 1998 to almost 212 million in 2001; this is roughly 80 percent of the eligible acres. Participation in revenue product coverage has more than tripled during this period. Furthermore, 81 percent of the acres insured were insured with coverage levels greater than 50 percent in 2001 (See Figure 1).

Figure 2 demonstrates that as coverage levels increase, the number of claims increase dramatically. According to RMA's data, policies issued in 1999 at the 55 percent level of coverage had a claims frequency of 33 percent. This contrasts with claims being filed 56 percent of the time on policies at the 85 percent coverage level. This has been a steady trend through the years.

If the producer files a claim during the year, additional work is needed to service his policy. When producers carry higher levels of coverage, the resulting lower thresholds of loss trigger a higher frequency of claims. While this is to be expected, more losses equate to more work and expense to service the policy.

The companies work efficiently to deliver the program. Since 1998, the costs associated with delivering the program have increased. Regulatory changes, compliance requirements, new products and more training of staff, agents and loss adjusters have all contributed to increase costs of delivery. Since 1997, there have been more than 200 Manager's Bulletins issued regarding programmatic changes, additional compliance manual changes and a major restructuring mandated by the passage of the ARPA. The additional expenses resulting from Farm Service Agency reviews, data reconciliation and data mining have been borne by the industry without any additional reimbursement.

Due to regulatory and compliance requirements, it costs more than the current average reimbursement rate of 21.5 cents on the dollar to deliver crop insurance to farmers. Crop insurance companies have been offsetting the operational deficit in delivery expenses in recent years with underwriting gains. The years 1994 to 2001 were exceptionally good crop years and provided underwriting gains. This, of course, cannot be relied on in every year. A portion of any gain must be held in reserve by the companies to help them weather the loss years. In 2002, the industry paid record levels of indemnities—more than $4 billion. These payments produced underwriting losses to the industry and the largest writer of crop insurance did not survive.

Renegotiation of the Standard Reinsurance Agreement (SRA)

ARPA provides that RMA may renegotiate the Standard Reinsurance Agreement (SRA) with the companies once during the period of 2000 to 2005. We anticipate RMA will open negotiations of the agreement for 2005 some time this year. As mentioned, the SRA covers all the terms and conditions under which the companies must deliver the MPCI products. Three areas of particular concern to the industry, which could dramatically change the economic stability of the industry, are: (1) a reduction to the A&O expense reimbursement, 2) a reduction to the allowable underwriting gains and 3) any change to the profit-loss sharing parameters.

For the reasons stated earlier, reductions to the A&O expense reimbursement or the underwriting gains threaten the underlying economic viability of each company. Lastly, because companies set out their operational risk strategy on a long-term basis, it is important that companies have some assurance the profit loss sharing parameters will not change from year to year. Even slight changes to this portion of the SRA could greatly impact the economic stability of the industry if companies are asked to take on more of the risk while not allowed a greater opportunity for gain.

New Product Development. The crop insurance industry is very interested in delivering insurance products that meet the risk management needs of producers. However, new products present unique challenges to the industry. For example, livestock products are much different than crop products. There is a separate SRA for livestock products, with a different risk sharing agreement. In addition, at this time, there is a limited reinsurance market for these products. It is difficult to determine if the insurance product has been rated properly until it has a proven track record, more information is available on the marketing cycle and there is an established use by producers. Furthermore, companies have been required to make significant technological investments to deliver these products and agents must receive special training and certification. Companies are not reimbursed for these additional costs to deliver these products. Fraud and Abuse

The crop insurance industry is not immune to fraudulent schemes by persons wishing to abuse the system. Crop insurance companies share in the losses paid on fraudulent claims, therefore, there is a financial incentive for companies to thoroughly review claims and report incidents of fraud and abuse. The crop insurance industry deplores fraudulent actions that abuse the system. However, we do not believe the incidence of fraud is greater in crop insurance than in other lines of insurance. Like any type of insurance, there is always someone trying to dishonestly make a fast dollar.

Insurance fraud is the second most committed economic crime in America today, second only to income tax evasion (Data from Conning & Co., a research and investment company specializing in the insurance industry). The majority of insurance fraud cases do not rise to the level of monetary threshold established by US Attorneys nationwide. However, with fraud on crop insurance we have access to the US Attorneys and the Federal Court system through the RMA and the Department of Agriculture Office of Inspector General.

There is ample Federal authority to combat any fraud and abuse problems under current law. The Agriculture Risk Protection Act of 2000 (ARPA) increased sanctions that can be imposed on producers for program abuses. RMA now has the authority to disqualify producers, agents, loss adjusters, and insurance providers from the crop insurance program. Producers may even be disqualified from most other farm programs. ARPA also required the Risk Management Agency (RMA) and the

Farm Service Agency (FSA) to work together to reconcile the two agencies' databases in order to strengthen oversight by identifying discrepancies and possible abuses. The crop insurance industry supports these provisions in ARPA and the zealous prosecution of abuse cases.

Fraud referrals from crop insurance are noticeably lower than referrals from other property and casualty lines of business, approximately 30 percent lower. Perhaps, this is due to the on-site, face-to-face adjusting conducted by our adjusters. In the past four years, the corporate investigative services and special investigations unit have averaged five fraud referrals per year. In the fall of 2000, an audit identified 50 claims as suspicious. Those claims were reviewed and returned to the adjuster to be corrected through routine adjusting procedures.

The crop insurance industry applauds prosecution of bad actors. Prosecution serves as a deterrent to those who are inclined to attempt to scam the system, much like the prosecution of income tax evaders deters tax fraud. Furthermore, the crop insurance industry recognizes that most producers honestly use crop insurance as an important risk management tool.

Crop insurance companies are actively training their agents and loss adjusters to deter fraud, waste and abuse. The crop insurance companies actively monitor statistical claim information, verify the accuracy of the information provided by the policyholder and the determinations made by the loss adjuster. Additionally, the crop insurance companies are required to conduct a set number of audits each year, depending on the number of policies they issue.

Crop insurance is a very successful program delivered by private industry. The industry is committed to delivering a viable risk management tool to producers that provides meaningful coverage and is actuarially sound. We want to work with Congress and RMA to make the program easier to administer, which in turn would reduce costs for all parties in this public-private partnership. It is a turbulent time for the industry—we need stability that includes no major changes in the program, which could jeopardize a vital successful program.

Thank you again for your invitation, I hope I have provided you with an informative snapshot of the challenges the industry faces and I will be happy to respond to your questions.

STATEMENT OF ROSS J. DAVIDSON, JR.

Mr. Chairman and members of the subcommittee, it is a pleasure to appear before you to discuss the progress and challenges of the Federal crop insurance program. The primary mission of the Risk Management Agency (RMA) is to promote, support and regulate the delivery of sound risk management solutions to preserve and strengthen the economic stability of America's agricultural producers. In fulfilling this mission, RMA is also responsible for implementing decisions made by the Federal Crop Insurance Corporation (FCIC) Board of Directors (Board).RMA has made significant progress in implementing the letter and intent of the Agriculture Risk Protection Act of 2000 (ARPA). ARPA charged the U.S. Department of Agriculture (USDA) and RMA to enhance the Federal crop insurance program to better serve our nation's agricultural producers. Specifically, these enhancements include:

- Improving program integrity, compliance and regulation
- Expanding crop insurance to include livestock, rangeland and forage
- Expanding agriculture assistance programs to include additional underserved states and producers
- Increasing risk management education and outreach to help more producers better mitigate their risks
- Expanding specialty crop programs to reach more producers

GENERAL OVERVIEW

The Federal Crop Insurance Program, administered by RMA, is a government-private sector partnership in which RMA oversees the sale and service of crop insurance by 18 private insurance companies, reinsured by FCIC, through licensed private agents and brokers. This system includes over 25,000 professionals consisting of RMA, the reinsurance companies, insurance agents and loss adjusters. Reinsured companies are responsible for marketing the policies, collecting premiums, and resolving producers' claims.

RMA has demonstrated its continued service to producers during drought stricken years by in good faith paying all legitimate indemnity claims. For CY 2002 this amounted to over $4 billion in indemnities compared to $3 billion for CY 2001.

A variety of insurance products are available to producers, including yield-based plans, revenue insurance plans, dollar plans, and pilot programs for livestock, rangeland and forage, and specialty crops. RMA has nearly 30 feasibility studies and product developments currently underway. Significant demands are placed on RMA to monitor, update and keep up with technology advances, changing and growing farm practices, and new, uncovered risks. RMA's 10 regional offices serve all 50 States and Puerto Rico, keeping in close contact with local producers, grower groups, universities, and government agencies. These offices provide information on local pilot programs, growing conditions, participating crops, reinsurance companies and agents, events, and training.

AGRICULTURE RISK PROTECTION ACT OF 2000 (ARPA)

Program integrity, compliance & regulation. As directed by ARPA, RMA instituted new provisions strengthening program integrity and compliance, which have shown positive results. While RMA believes that most producers use good farming practices and comply with Federal regulations, there are some instances of waste, fraud and abuse. As a result, RMA has launched several oversight efforts, which have proven successful in deterring and detecting fraud.

To combat fraudulent claims, RMA provided crop insurance oversight training to FSA personnel in 2,500 FSA service center offices. This training helps RMA and insurance providers monitor crop conditions and producer behavior during the growing season through on-site FSA inspections. USDA's 2001 Compliance Report to Congress noted that RMA has reduced program costs an estimated $94 million by preventing payments on potential fraudulent claims. Although prevention efforts and implementation of the Act have been major priorities for RMA, traditional investigation and criminal, civil, and administrative processes are continually ongoing and have generated recoveries of approximately $35 million in overpaid indemnities.

APRA also required the use of data mining and data warehousing "to administer and enforce" the crop insurance program. The Center for Agribusiness Excellence (CAE) contract requires an annual spot check list be extracted from the data warehouse through data mining. The purpose of the spot check list is to identify producers who should have growing season inspections performed. The spot check list is then forwarded to FSA after RMA's six Regional Compliance Offices review and revise the list. Producers on this list were identified through data mining utilizing five scenarios:

- Triplets—Agents, adjusters, and producers linked anomalous behavior suggestive of collusion (as required by ARPA)
- Frequent Filers—Anomalous producers with consecutive multi-year losses
- Added Land/New Producer—Anomalous producers who appear to abuse the added land and new producers provisions
- Cotton Yield Switchers—Producers identified by Illinois Institute of Technology Research Institute (IITRI)
- Frequent Losers—Anomalous producers identified using criteria developed by a Regional Compliance Office Director.

The indemnities of the producers on the spot check list reduced substantially from 2001 to 2002, from over $210 million to just over $100 million. This translates into approximately $110 million in cost avoidance.

In addition, RMA is upgrading its Geographic Information System (GIS), using current mapping and imagery technology, and infrared data to assist in making compliance determinations. For example, RMA began monitoring the lay down of raisins from the air using aerial infrared images in combination with field visits by RMA personnel to deter potential crop insurance abuse due to low prices and other market conditions. In combination with favorable weather conditions, these efforts resulted in maintaining a very low loss ratio on approximately 400, 000 acres of raisins. Now, RMA is looking at further integrating imagery technology into its data mining effort to reduce and prevent fraud.

GIS provides timely and historical imagery analysis of individual fields and tracts. A GIS workstation has been established in every regional and compliance office using Environmental Systems Research Institute (ESRI) software. RMA is also working with business partners, private industry and other government agencies to enhance our GIS technology. These combined efforts provide additional help in preventing, deterring and prosecuting crop insurance fraud through information technology.

Livestock, Rangeland & Forage. ARPA authorized RMA to insure several types of animals and animal products, including dairy. RMA recently announced a Livestock Risk Protection (LRP) pilot program for fed and feeder cattle. Both risk protection plans protect cattle producers from declining cattle prices. Sales open for both products on June 9, 2003. Additionally, RMA is entering its second year of insuring slaughter hogs in Iowa under two different pilot insurance plans. The LRP pilot program provides swine producers with protection from declining prices. The Livestock Gross Margin (LGM) pilot program protects swine producers from increasing prices in corn and soybean meal and/or declining slaughter hog prices. Several other livestock initiatives are currently underway, including two contracts: a feasibility study for various livestock related insurance plans and another contract to study possibilities for insuring against catastrophic livestock diseases, both of which include dairy. RMA has received interest from many states in the expansion of the Adjusted Gross Revenue-Lite (AGR-Lite) program. Recently the Pennsylvania Department of Agriculture submitted certain changes and requested the expansion of the AGR-Lite program. On May 7, 2003, the Board of Directors sent the submission out for review by five external reviewers.

RMA is also testing pasture and forage products in order to fulfill ARPA requirements. The Group Risk Protection (GRP) rangeland pilot is currently offered in twelve Montana counties. While this product is not working as well as RMA or producers would like, RMA is doing everything possible to ensure that the discovery and determination of yields used to make loss payments are accurate and fairly represent the crop year's production experience of Montana's rangeland producers. RMA has contracted for an evaluation of the GRP program and a feasibility study specifically for pasture and rangeland to determine if an individual risk management program can be developed rather than the group program.

The performance of the Actual Production History (APH) forage program is being reviewed and a contract has been awarded to improve the loss adjustment methodology and determine the feasibility of a forage quality adjustment endorsement.

Participation. In response to subsidies provided by ARPA and an aggressive education program, farmers have actually purchased higher levels of protection and revenue crop insurance coverage policies. In 2002, over 50 percent of the insurable acreage was insured at 70 percent coverage or higher compared to only 9 percent in 1998. The high participation rate and the higher levels of coverage purchased have enhanced the ability of crop insurance to become the main risk management tool for America. In addition, the increased number of farmers buying up higher levels of coverage has generated increased efficiencies.

However, the traditionally underserved states still lag in participation. The main reason given for this lower participation has been unavailability of appropriate coverage and the perceived high cost of buy-up coverage. RMA is working assiduously to promote and facilitate the development of revenue and specialty crop insurance to address availability questions and affordability concerns.

Secretary Veneman asked the Risk Management Agency to undertake a major initiative in 2003 to identify the underserved producers and closely examine the regions, commodities and the risks. ARPA provided funding for the Agriculture Management Assistance program, and then was modified to include additional funding by the 2002 farm bill. In February, the Department announced an effort to better serve the 15 historically underserved states targeted under the Agricultural Management Assistance program by providing up to $18 million in additional subsidy for higher levels of coverage through the Targeted States Financial Assistance program.

This program, which is designed to increase participation in the crop insurance program and help producers manage production, price and revenue risk, has been very successful. Providing this additional financial assistance has encouraged many producers to purchase crop insurance for the first time and has allowed producers to purchase the maximum coverage level available. RMA has received many positive letters from producers, producer groups and insurance agents in many states who are pleased with the program. We expect to have more definitive participation data later in the summer, after acreage reporting dates have passed, and we will be pleased to share that with you.

Education & Outreach. RMA targets risk management education activities to states that have been underserved by crop insurance. The Secretary selected 15 states for this program: Maine, New Hampshire, Vermont, New York, Connecticut, Massachusetts, Rhode Island, New Jersey, Delaware, Pennsylvania, Maryland, West Virginia, Wyoming, Utah, and Nevada. These states have a disproportionately large share of small farms. In 2002, RMA established 13 cooperative agreements totaling $1.8 million to deliver crop insurance education and information to producers in the 15 underserved states.

In addition, RMA awarded 72 partnership agreements to conduct producer training in risk management, with a priority to producers of specialty crops. These agreements were awarded to universities, grower groups, private agribusiness organizations, and state departments of agriculture across the country.

In fiscal year 2002, RMA's Civil Rights and Community Outreach division entered into 46 outreach partnerships totaling over $3 million dollars, covering approximately 34 states serving women, Asians, African Americans, Native Americans and Hispanic farmers and ranchers. Through these partnerships, women, limited resource and other traditionally under served agricultural producers will receive program technical assistance and training on the availability and use of risk management tools to improve their economic viability.

RMA has also participated in 14 public educational briefings across the country on the 2002 farm bill and USDA programs and services.

Recent Activities & Updates

Drought Coverage. As you are aware, excessive drought has plagued and continues to affect many producers in the U.S. RMA recognizes this challenge and has several programs that address the needs of drought-stricken producers. Prevented planting provisions cover producers in times of excessive and multi-year drought. Recently, RMA provided supplementary information explaining prevented planting policies to producers. Most producers have found that they are covered better than they originally thought. Additionally, RMA is holding a series of prevented planting forums consisting of RMA, insurance industry representatives and commodity group representatives to improve RMA's prevented planting coverage for the future.

To mitigate the effects of drought on Actual Production History (APH) yields and insurance coverage, yield substitutions authorized by ARPA are in place. This allows producers who have suffered catastrophic losses to receive a yield equal to 60 percent of the transitioned yield for the county. RMA is also evaluating the possibility of requesting revisions to the yield substitutions to determine if more assistance can be provided to address long-term production declines such as those induced by extended drought.

Information Technology & Common Computing Environment. RMA's FY 2004 request of $78.5 million for Administrative and Operating Expenses represents an increase of about $8 million from FY 2003. This budget will support increases for information technology (IT) initiatives in the amount of $5.5 million. These IT funds are targeted towards the continual maintenance and enhancement of the corporate operating systems necessary to run the program.

This budget also includes a funding request of about $8.7 million for information technology for RMA under the Common Computing Environment (CCE) in the budget of the Chief Information Officer. In addition, RMA has an aging information technology system, of which the last major overhaul occurred about 10 years ago. The funding requested under the CCE will provide for improvements to RMA's existing information technology system to improve coordination and data sharing with the insurance companies and FSA. The funding will also provide for the development of a new information technology architecture.

American Growers Insurance Corporation. RMA continues to work with the Nebraska Department of Insurance, the rehabilitator of American Growers, in assuring the timely service and payment of claims. As of last week, fewer than 275 open claims of the 28,611 were pending and an additional 24 new claims were added. The transfer of 2003 crop year policies to other active companies is proceeding. All fall 2003 policies have been transferred to other companies and RMA is in the process of transferring the rest of the spring 2003 policies. Substantial work remains in areas such as completing claims processing, safeguarding crop insurance records and disposing of company property.

RMA's oversight and advisory team of four senior managers rotate their time onsite in Council Bluffs. In addition, many other RMA employees are involved in supporting this on-going effort. Although most of American Grower's employees have been separated from employment at this time, RMA acknowledges that without their assistance and dedication to getting the 2002 claims paid, this project would not have been as successful as it was. RMA also recognizes that the remainder of the crop insurance industry has assumed the American Growers producer policy business. We believe this has been a very good example of Federal-state regulatory cooperation.

Although the final accounting analysis of American Growers remains incomplete, it appears the company may have made management and/or operational decisions prior to 2002 that caused its continued survival to be dependent on earning sizeable underwriting profits for the 2002 reinsurance year. With a greater than normal loss year, the underwriting gains did not materialize, leaving the company unable to meet expenses. As a result, RMA recognizes the need for closer scrutiny of company expenses in the future is desirable.

Secretary Veneman recently charged RMA to "examine its own authorities and processes to ensure effective oversight of the industry." RMA has determined that additional reporting and review is necessary to anticipate insurance company problems in advance. RMA is considering several changes in its authorities and organizational structure to increase oversight of the companies participating in the Federal crop insurance program.

Premium Discount Plan. Converium and Crop1 Insurance companies, under section 508 (e) (3) of the Federal Crop Insurance Act, submitted the Premium Discount Plan (PDP) to the FCIC Board. The Board recommended approval of PDP if RMA determined that Crop1 and Converium met the requirements of the Act and the other procedures created by the Board. After rigorous review and approval by the Board, RMA authorized the PDP in seven states for five crops in each state for the 2003 Crop Year.

Under PDP, the premium paid by producers to purchase crop insurance was reduced commensurate with cost savings achieved by Converium and Crop1 primarily through the use of their enhanced computer operating system and use of affiliates to make insurance more accessible to producers. Converium, the SRA holder, has recently discontinued its relationship with Crop1. RMA is working closely with these entities to ensure that services to producers are completed correctly and in a timely manner for all 2003 policies purchased through Crop1.

Because approval was based in part on the relationship between Crop1 and Converium, the existing PDP program has not been approved for crop year 2004. However, PDP can be resubmitted for approval for the 2004 crop year. RMA recently published procedures by which any reinsured company may apply to offer a premium reduction plan, under strict standards for approval and operation. These procedures were reviewed and commented on by independent insurance companies. RMA has and will continue to exert careful regulatory oversight of these types of programs to ensure compliance with Federal law and the provisions of the Standard Reinsurance Agreement, particularly with respect to the proper use of licensed agents, producer service, and illegal rebating and tying prohibitions.

Portfolio Review. In fulfilling ARPA requirements, Secretary Veneman recently asked RMA to review its products, commodities, risks and areas covered to better serve producers. RMA is undergoing an extensive product portfolio review, conducting listening sessions with producers across the U.S. and identifying crop insurance priorities of local and national producer groups, lenders and state departments of agriculture to identify ways in which it can improve and fine-tune its products. For example, RMA, in conjunction with U.S. Apple Association, has been working to make improvements to the current apple policy. While several options are being considered, it is important that meeting the needs of producers is first and foremost. Members of U.S. Apple and producers have been pleased with the discussions thus far. We hope to reach a consensus soon and will do everything within our authority to expedite the appropriate changes.

FUTURE PROGRAMS

Basic Provision. RMA has incorporated the final requirements as mandated by ARPA into its Common Crop Insurance Policy for Basic Provisions, which is currently in departmental clearance. We recognize that there are several questions surrounding these changes and hope to publish the Basic Provisions in the near future.

Cost of Production. Cost of Production (COP) is a new and untested insurance concept and approach. Many issues, including program design, rating, delivery and administration, still must be addressed. RMA and the contractor on this product are currently addressing the issues raised by independent expert reviewers, RMA staff, the Office of General Counsel, and Board members during the Board's consideration and approval process. We expect to revisit these issues by mid-summer when the product is resubmitted for the Board's re-consideration. Pending resolution of these issues to the Board's satisfaction, a policy for cotton may be available for the spring 2004 Crop Year. Any decision to expand this program to other crops would be decided by the FCIC Board of Directors, taking into consideration the experience of any initial pilot program.

Standard Reinsurance Agreement. The Standard Reinsurance Agreement (SRA), the Livestock Price Reinsurance Agreement, and the Aquatic Crop Reinsurance Agreement are considered cooperative financial assistance agreements between the FCIC and the insurance company named on the agreement. Each reinsurance agreement establishes the terms and conditions under which the FCIC, with delegated authority to RMA, will provide subsidies and reinsurance on eligible crop insurance contracts. The current SRA has been in effect since 1998 and includes a provision for renegotiations on an annual basis (from July 1 to June 30) provided the Department gives notice at least 180 days in advance. ARPA authorizes the Department to renegotiate the SRA once before 2005. In December 2002, USDA announced that the RMA's Standard Reinsurance Agreement and Aquatic Crop Reinsurance Agreement would remain in effect for the 2004 reinsurance year. RMA plans to announce renegotiation of the SRA and the ACRA effective with the 2005 reinsurance year in the coming weeks.

Since the passage of ARPA, RMA has been very active in accommodating the needs of American producers through additional products. RMA has reduced program costs by preventing payments on potential fraudulent claims. Data mining efforts successfully reduced indemnities by approximately $110 million. Improvements and enhancements are being made to GIS, infrared, and other information technologies as well as the Common Computing Environment. New specialty crop and livestock pilot programs are currently underway. Education and outreach programs have been enhanced and expanded to help more producers learn how to better mitigate their risks. RMA continues to service producers that have been plagued by excessive drought. As demonstrated by my testimony today, RMA is proactively striving to fulfill Secretary Veneman's continued commitment to better serve our nation's producers.

Thank you, Mr. Chairman and members of the subcommittee. At this time, I will respond to any questions.